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into
Residential Tenancies

The Normative Bases of Rent Regulation

W. T. Stanbury

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by

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author and not necessarily those of the Commission.

W.T. STANBURY is UPS Foundation Professor of Regulation
and Competition Policy, Faculty of Commerce and Business
Administration, University of British Columbia.

PREFACE AND ACKNOWLEDGEMENTS

This study was one of three volumes prepared in draft form prior to the author's testimony before the Ontario Commission of Inquiry into Residential Tenancies that began on October 9, 1984. The other two volumes are as follows: (i) W.T. Stanbury, The Normative Bases of Government Action, Research Study No. 16 (Toronto: Ontario Commission of Inquiry into Residential Tenancies, 1985); and (ii) W.T. Stanbury and Peter Thain, The Origins of Rent Regulation in Ontario, Research Study No. 17 (Toronto: Ontario Commission of Inquiry into Residential Tenancies, 1985).

Although the author has had an opportunity to revise this study, the reader should appreciate the basic constraint under which the first draft of all three volumes was prepared. The total time available to prepare the studies was less than four months. Given the wide scope of the research and the importance of rent regulation to both landlords and tenants in Ontario, more time would have been highly desirable.

Happily, the analysis presented in this study held up quite well to cross-examination and to the comments of the referees. In response to the questions of Alderman Ron Kanter, I prepared a short discussion on the sixth principal normative argument for rent controls. It can be found in Chapter 5.

In the year since the first draft of this study was completed, the Commission published or had available in first draft form a number of additional studies of rent control in Ontario. While I have benefitted from reading most of these, it was not necessary to incorporate many of the findings, as they focus mainly on the effects of controls and this study focuses on the arguments for rent controls in Ontario, made primarily in the period before they were introduced in late 1975. (Stanbury and Vertinsky (1985) provide a detailed survey of studies on the effects of rent controls in Ontario.)

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W.T. Stanbury
Vancouver, B.C.
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Chapter 1

INTRODUCTION

> Rational choice involves two kinds of guesses: guesses about future consequences of current actions and guesses about future preferences for those consequences. ...We try to imagine what will happen in the future as a result of our actions and we try to imagine how we shall evaluate what will happen. Neither guess is necessarily easy (March, 1978, p. 589).

1.0 FOCUS OF THIS STUDY

This study was one of three prepared as background material for the author's testimony as part of Task A of the second phase of the work of the Ontario Commission of Inquiry into Residential Tenancies. Task A is concerned with understanding the possible objectives of rent regulation as it does or ought to exist in the province of Ontario.

In this volume I focus on the arguments made in support of some type of rent regulation: why such regulation ought to be introduced, retained, or modified to make it more effective from the point of view of its proponents. These arguments, by definition, are based on value judgments. They are not designed to predict behaviour, but to alter it by persuasion. Of course, persuasion also depends on appeals to emotion, as well as on logical argument buttressed by facts. Therefore, one should not be surprised to find that some of the arguments for rent regulation as advanced by its proponents are not articulated in any detail. They may rely on implicit assumptions and upon the use of evocative "code words" in order to appeal to others. None of this should, however, be taken as impugning their sincerity or the intensity of feeling about the perceived problem(s). Therefore, we have sought to identify, classify, and also to articulate and to analyze the most important normative arguments for the regulation of rents.

Such arguments may be made prior to the introduction of some form of rent controls or they may be made after controls are in place to rationalize or to explain why they should continue or be modified, or why they ought to have been imposed in the first place, i.e., a form of ex post facto rationalization.

As we point out in section 6 below, a large number of normative arguments have been advanced to support rent regulation in some form. We have identified what appear to be the five most important ones and have grouped them into three analytic categories based on our research in other areas of government regulation and into government intervention generally.

The six normative bases of rent regulation arranged in three more general categories are as follows:

(1) Actions by government designed to alter the distribution of income, wealth or consumption opportunities.

   (a) To prevent rent "gouging" or "unconscionable" increases in rent so as to prevent landlords from obtaining "exorbitant" profits or "unearned windfall gains". See Chapter 2.

   (b) To maintain or increase the amount of "affordable" rental housing for households with low incomes. See Chapter 2.

   (c) To maintain a mix of types of housing, types of tenure and distribution of households by income level in order to obtain diversity and balance of residents and economic activity in the central area of major urban centres, notably Toronto. See Chapter 5.

(2) Actions by government to create certain rights and thereby remove certain things from the market exchange process.

   (a) To provide security of tenure for tenants as a right independent of rent control or as a complement to such controls. See Chapter 3.

(3) Actions by government to improve the efficiency with which society's scarce resources are allocated.

  (a) To remedy certain problems in rental housing markets said to be market failures, e.g., imperfect information and high transaction costs.

  (b) To stabilize the adjustment path of rents in disequilibrium situations in the rental housing market in order to reduce the economic costs of the process of adjustment. See Chapter 4.

2.0 THE GENERAL APPROACH

Those most closely involved in advocating, opposing, administering or simply being subjected to a particular system of rent regulation as landlords or tenants may believe they are dealing with a unique form of government intervention. They may believe that the arguments for rent regulation are *sui generis* and that the policy can only be understood in its own terms or in terms of the experience of other cities, states or nations that have imposed rent controls. I do not believe that this is the case — see Stanbury and Vertinsky (1985).

The approach taken in the body of research I have conducted for the Commission of Inquiry has been to apply to the phenomenon of rent regulation in Ontario the analytical insights gained from the large body of research on government regulation of *many* types ranging from agricultural products supply management boards to airline regulation to the regulation of taxi cabs by local governments.[1] This work has been aided by research associated with the considerable amount of regulatory reform — including total deregulation — that has occurred in the United States[2] and that has been studied and debated extensively in Canada.[3]

At the same time, it must be recognized that regulation is only one of a number of instruments used by governments to effect their purposes. Others include direct expenditures (both exhaustive and transfers to persons, firms and other governments); taxes; Crown Corporations; "tax expenditures" (i.e., "giving by not taking" -- legal exemptions, tax credits and lower rates for certain types of income); mixed enterprises, i.e., where a government participates in the voting shares of a firm along with private investors; loans and loan guarantees; and the exercise of suasion, i.e., efforts to alter the behaviour of firms and individuals in the private sector by "persuasion" without resort to legal coercive measures.[4] Recent research has examined the extent to which these various instruments are substitutable for each other.[5] While each has advantages and disadvantages as seen from the perspectives of various actors (politicians, bureaucrats, voters), all are used in varying degrees and under different conditions[6] to effect three general normative purposes: to alter the distribution of income, to improve economic efficiency, and to create rights.

While normative arguments suggest what government ought to do, positive theories and analyses of the behaviour of governments seek to explain the why of governments' actions and to predict their future behaviour under certain conditions. In particular, the positive theories and analyses focus on the behaviour of politicians and voters in the political arena which produce policies that are designed to alter the distribution of income and/or wealth.[7]

Preparation for the testimony on the normative arguments of rent regulation in Ontario proceeded in two stages. I began by reviewing the normative bases for government intervention to influence economic activity in general. The results of this work are reported in Stanbury (1985). Its purpose is to provide the analytical framework for the discussion of one type of regulation in one jurisdiction, rent regulation in the province of Ontario.[8]

The second stage of the research consisted of applying the general analytical framework to the case of rent regulation in Ontario. The results of this work are reported in this volume. Most of the parties appearing before the

Commission of Inquiry into Residential Tenancies will necessarily wish to focus on the arguments for rent regulation in Ontario.

Why is this approach useful? First, an examination of the normative bases of all types of government intervention in the economy provides a general framework within which to analyse a specific policy. The general framework adopted here has been used with effect in many analyses of other forms of government regulation. There was reason, therefore, to believe it would be fruitful in this case as well.

Second, since all methodologies embody norms (usually they are implicit), it is desirable to make as explicit as possible the way in which a particular problem is to be analyzed. The approach adopted here is obviously not the only one that could have been employed, but because it has been used before and is made explicit through the work reported in Stanbury (1985), readers will be clear as to the methodology employed.

Third, an analytic framework that is larger and more general than the case at hand provides both perspective and a basis of comparison. There is a danger in analyzing a particular type of government action in isolation from other policies and from the bases of government action in general. The "uniqueness" of the problem may be exaggerated. What appears to be a special case may really, under a different label, be part of a much larger category about which we have both more theory and empirical evidence which may be brought to bear on the problem at hand. As we shall see, the normative bases of rent regulation discussed in this volume, despite its special terminology and particular issues, are really a subset of the arguments for government intervention in general.

This volume uses the framework developed in Stanbury (1985) to analyze the normative arguments for rent regulation in Ontario. In terms of background to what follows it should be appreciated that rent regulation is a type of government action that has both a long and "wide" history. In North America or

Western Europe such controls date back to at least World War I and have existed -- in one form or another and for different periods of type -- in the United States, the United Kingdom, Austria, Sweden, France, and of course, Canada.[9] Second, some type of rent controls were in place in Quebec, British Columbia and Newfoundland (rent review) before the Province of Ontario adopted them in 1975,[10] so that Ontario was hardly the pioneer in Canada in imposing controls during the 1970s. Given the popularity of this form of government intervention, it is desirable to understand the arguments that lie behind it. Third, it appears that the set of arguments in support of the continuation of rent regulation in Ontario is much larger than it was when they were first introduced in 1975. Stanbury and Thain (1985) indicate that the most important normative basis was the desire to prevent "rent gouging" or "unconscionable" increases in rent. While arguments concerning "affordability" and security of tenure for tenants are, as we shall see, high on the agenda today, they were used very little in 1975. As I shall discuss in Chapter 2, regulation creates interests in its preservation. As circumstances change and a policy evolves, the arguments for its continuation and/or modification are likely to alter. Chapters 2 through 5 deal with those arguments that are high on the current agenda.

3.0 THE IMPORTANCE OF UNDERSTANDING THE NORMATIVE BASES OF GOVERNMENT ACTION

3.1 Objectives in a Policy Analysis

Why should we inquire into the normative bases of a particular public policy or government action? The most important reason lies in the nature of attempting to employ a rational approach to decision making and policy formulation. As Quade (1975, p. 20) points out, "if a study is to analyze all aspects of a decision problem, it must include the following:

1. An investigation of what it is the decision-maker seeks to accomplish...;
2. A search for alternative ways of achieving the objectives...;
3. A full comparison of the alternatives in terms of their impacts...;
4. A consideration of all significant aspects of the problem...; [and]
5. An interactive approach...".

The first element, the specification of objectives, includes a diagnosis of what is perceived as the problem, i.e., some gap between the present state and the desired state. The objectives a policy maker seeks may not be well specified or well thought out. Moreover, some of the implications of these objectives may not be clear. In Quade's (1975, p. 20) view, "these implications should be investigated and operational goals determined and communicated by the analyst".

Lest we "ride off in all directions", it is critical, as part of the initial stage in a policy analysis, to clarify the problem. How did the problem arise? Who perceives that there is a problem? How big is the problem? In some cases, people over-generalize from one or two dramatic examples to conclude there is a widespread evil which, upon closer examination, is much more localized than they originally believed. Moreover, which individuals, group, region, etc., is most severely affected by the problem? Quade (1975, p. 35) argues that it is vital as an initial step in the analysis of a policy or proposed policy to conduct a detailed investigation of the assumptions underlying people's perception of a problem requiring government action.

Normative arguments for a particular public policy contain (usually implicitly) some type of "problem diagnosis" and one or more objectives the policy is designed to serve -- see Stanbury and Thain (1985). "Often the most difficult task for the analyst is to discover whether or not objectives, often stated or implied by the [advocate of the policy] in such general or abstract terms as to be ambiguous, are really the objectives that are wanted..." (Quade, 1975, p. 46).

An analysis of objectives necessarily requires one to inquire into values and ultimate goals which form the bases of the criteria by which alternative policies are to be judged. In the first instance, it is reasonable to evaluate a policy in its own terms -- in terms of the objectives it was designed to achieve. The efficacy of an alternative in achieving the stated objectives should be separated from any debate about the desirability of the objectives themselves.

Since the discussion of objectives, or the normative bases, of a policy is the most common starting point for a policy analysis, it is critical to the whole exercise. Quade (1975, p. 84) argues that

> It is crucially important to choose the "right" objective, more important than it is to make the very best choice among the alternatives. A wrong objective means the wrong problem is being tackled.... To be "rational" in our choice of actions, we have to know what we want to achieve. Until it is decided what a policy or program is supposed to accomplish, information about alternatives, costs, and effects has no particular value except insofar as it helps to firm up the goals.

If multiple goals are inherent in a broadly based policy (see below) like rent regulation, which goals are more important than others? An analysis of a policy's normative bases may be helpful in determining the hierarchy of its goals. Since statements about goals are often aimed at legitimizing certain forms of behaviour, the apparent conflict of objectives may be more apparent than real if some of the stated objectives are really "window dressing". Real priorities are those for which one is willing to sacrifice other objectives and for the achievement of which one is willing to make a significant commitment of resources.

3.2 Problems in the Analysis of Objectives

There are real difficulties involved in analyzing the normative bases of particular public policies, particularly those already in place. Any broadly based policy such as rent regulation usually seeks to achieve, not a single objective, but rather a number of often conflicting ones. Mitnick (1980, p. 281) states that

> legislatures like many other groups, usually need to offer a single coherent reason for the collective decision [to intervene], as if a single individual were deciding. This will tend to reduce uncertainty for organizations [and individuals] in the legislature's environment... .

Vague legislative rationalizations are offered because the legislative decision involves the aggregation of conflicting preferences, and because legislation recognizes that there may be changes in the importance of the interests involved in the consequences of the decision. The tendency is for legislators to state objectives as broad statements of direction, rather than as a precise target.

The normative bases of many public policies are often vague or ill-defined. This merely reflects the "full richness of the political problem" (Hartle, 1979, p. 26). The problem is that even with "motherhood" statements, "goals are not independent of each other [e.g., full employment and price stability] nor of other goals; [and] voters are not indifferent about who will obtain the benefits and who will bear the costs" of achieving such goals (Ibid.). It may be easier for conflicting interest groups to agree on an action than it is for them to agree on a statement of purpose.

As Simon (1964) has pointed out, organizational actions must satisfy a whole set of requirements or constraints and it is conventional to single one out and refer to it as the goal of the action. He argues that, formally, objectives and constraints are interchangeable so that goals or objectives can be thought of as those constraints which motivate the policy/decision maker and guide his search for a policy action that will satisfy the set of constraints. The problem is compounded as the passage of time brings to the fore new policy actors, different values, and different economic and social conditions. Therefore, it is hardly surprising that essentially the same legislation is reinterpreted and said to be aimed at the achievement of quite different goals at different points in time.

Any analysis of the goals of a piece of legislation (and the policy of which it is a part) must be cognizant of the possible differences between stated objectives and "true" objectives. For the most part, we are forced to work with the public statements of politicians, bureaucrats, academics, and interest groups. To only a limited extent can we verify such statements with reference to observed behaviour. But statements about the normative bases of a government policy may not closely coincide with either the administrative behaviour of the agencies which implement the legislation or the actual effect(s) of the legislation in practice. There are simply too many actors and too many intervening variables to determine the linkages precisely.

Hartle (1979, p. 93) argues that "to assess existing regulations [or statutes] in terms of the degree to which they effectively achieve their stated objectives -- statements that usually are designed to persuade or obfuscate -- relative to alternatives would be largely a waste of time". Furthermore, he argues that to take the stated objectives of legislation at face value "would be to 'prove' that ministers collectively ... are either fools or knaves or both, which would be neither true nor fair". To do so is to ignore political realities, which include the need to make trade-offs, woo uncommitted voters, obscure from most voters the distributional implications of many policies, and provide room for adaptive responses to unpredictable shifts in voter preferences. We agree that these matters are important if we seek to explain the forces that brought a policy into existence or to predict the behaviour of actors in the political system. That is the role of positive theories of government action which are discussed in two research studies prepared for the Commission of Inquiry: Hartle (1984) and Stanbury and Thain (1985). They are less important if we wish to understand the arguments used by the advocates of a particular policy - although it is possible that they are using socially acceptable rhetoric to cloak rather more self-interested motives.

4.0 TERMINOLOGY AND BASIC CONCEPTS

It is easy to become tangled in terminology and fail to understand some of the basic concepts used to analyze the normative bases of government intervention. I propose to deal with four points under this head: the term "government intervention"; the distinction between "rationales" and objectives of government action; the difference between positive theories of and normative arguments for government action; and the distinction between the objectives and the effects of a public policy.

4.1 Government "Intervention"

The term government "intervention", for some, is an emotionally loaded term implying that the absence of government actions in a market economy is the ideal social arrangement. Therefore, any action by government amounts to "unnatural" intervention in what is held to be a smoothly functioning situation. Yet, the strongest proponents of a "virginal" market economy often ignore the fact that two of the foundations of a universal market economy--the institution of private property and the enforcement of contracts-- require government intervention.[11] Posner (1981, pp. 120, 121) suggests that

> truly limited government has only one function -- to assure physical security in both its internal and external aspects.... Without some minimal internal public order, community welfare would be diminished.

Life without a government to protect the security of the individual and to define and enforce property rights would be neither just nor efficient. Rather, it would be like Hobbes' description, "poor, nasty, brutish and short". The proponents of extreme versions of laissez-faire (e.g., Nozick, 1974), in emphasizing the importance of individual freedom, ignore the fact that government action can both constrain and effectively enlarge the individual's freedom.

Perhaps the phrase "government action" is more neutral than "government intervention." I shall try to use it in this study, but if the latter is used, the reader should not assume it has a pejorative meaning.

4.2 Rationales Versus Objectives

The literature on regulation and other forms of government activity often speaks of the "rationales" for such activity. Yet this term is often used loosely to refer to a number of different things. For example, it is used to refer to both positive theories ("what is") and normative bases ("what ought to be") of government action. (This distinction is discussed immediately below.) The term rationale is also used to refer to the objectives of a piece of legislation (or public policy generally) and sometimes, to the forces that combined to bring about the policy. I try to avoid using the term rationale because of the confusion in its meaning. Our primary analytic distinction is between positive theories or explanations of acts of government intervention and the normative bases or arguments for such action.

4.3 Positive Theories Versus Normative Arguments

Professor James March (1978, p. 588) notes that

> according to conventional dogma, there are two kinds of theories of human behavior: descriptive (or behavioral) theories that purport to describe actual behavior of individuals or social institutions, and prescriptive (or normative) theories that purport to describe optimal (or desirable) behavior. In many ways, the distinction leads to an intelligent, fruitful division of labor in social science reflecting differences in technique, objectives and professional cultures.

I define the normative bases of government action as propositions advanced to indicate why and under what conditions it is desirable for society to take collective action in the form of government intervention to influence the economic behaviour of private sector actors.

Positive theories or explanations of government action are designed to be objective and without normative premises. Such theories attempt only to explain and/or describe, but not to evaluate according to normative criteria. Positive theories of government action are concerned with what is rather than what ought to be. There is a difference between saying what is the case; what ought to be the case; and what is necessary or instrumentally useful given what ought to be the case. To go from the first to the second or third statement requires some normative premise on which to predicate the subsequent normative proposition. "Positive analysis examines what transpires independent of and as a necessary prelude to judgement and evaluation" (Samuels, 1978, p. 62).

In the public policy context, the emphasis in positive theories is on explaining why new legislation was enacted or why an existing policy was altered in a significant way. There is also an emphasis on predicting what is likely to occur under certain conditions. No consideration is given to whether or not the government action is desirable in some sense. In general, positive theories of government action tend to focus on political factors. Therefore, the role of interest groups, the motivation of politicians, and the behaviour of marginal voters (or voters in marginal constituencies) are central in positive theories of government intervention. See Stanbury and Thain (1985) and Hartle (1984).

This conventional distinction between positive and normative analysis can be somewhat illusory and reflects the fact that "economists have a rather guilty conscience about values" (Evans, 1982, p. 454). The distinction can be illusory, because, as Evans (1982, pp. 454-55) reminds us, the analysts' values enter into positive theories as a preanalytical cognitive act: "What we choose to study, how we define the essential properties of the objects of analysis, and what we think are their significant, as opposed to incidental, inter-relationships, all depend on our value system. ...[Moreover,] positive analysis in practice always embodies a number of simplifying assumptions, empirical judgments, and often just plain guesses, to move it across the gaps in which empirical evidence is missing, or more commonly ambiguous. In this process, of course, value judgments play an inevitable role." Therefore, in proposing and testing positive theories, the careful analyst ought (a normative proposition in itself) to make the judgmental aspects evident and the value judgments as explicit as possible.

4.4 Objectives Versus Effects

It is important to distinguish between the objectives of a public policy and its effects. We use the word "objectives" to refer to the intended effects or desired results of government action. For example, the objectives of rent regulation may include keeping rent levels below the level that would occur if the private market was allowed to operate freely. A particular system of rent regulation may or may not hold rents below the market-clearing level. That is an empirical question. Moreover, if regulation does achieve the objective of holding rents below the market-clearing level, it may produce other effects ignored or unanticipated by the proponents of rent regulation.

While this study focuses on the objectives of a particular public policy, it is useful to think for a moment about the concept of the effects of a public policy. For example, we agree with Page (1983, p. 208), who argues that to understand the effects of government actions we must think in a general equilibrium fashion.

> It is not adequate to view government actions as tacked onto the private economy, simply adding to or subtracting from what the market does. Government actions themselves affect the "private" behavior of individuals and firms as they make choices about work, savings, production, investments, and even living arrangements and family life. These choices, in turn, affect other "private" choices and reverberate throughout the economy so that the net long-run impact of a government policy may be quite different from its apparent short-run effect.

The time when the effects of government intervention will occur need to be specified. First, we must distinguish between short run effects and long run effects. In real time, the latter period refers to the time it takes for existing contracts to expire and new ones to be made, i.e., all factors become variables. In terms of a production process, there are no fixed costs. The long run refers to the changes that will occur over time as a new equilibrium is reached, barring further exogenous shocks.

Second, we must recognize that a policy is dependent upon the set of conditions in which it is embedded. Therefore, initially a policy change may produce effects quite similar to the objectives its instigators intended. However, the same government action may produce quite different effects (even contradictory ones) with the passage of time. This is not simply a matter of short run versus long run effects. Rather, the set of conditions (economic, social, political) in which the policy is embedded change. Hence the effects it produces change.[12]

4.5 The Meaning of Rent Regulation

It is easy to get lost at the outset of the discussion as to the meaning of such terms as rent regulation, rent review and rent controls — see Stanbury and Vertinsky (1985). The Ontario Commission of Inquiry into Residential Tenancies distinguishes between rent control (the ceiling on annual rent increases without approval) and rent review (applications by landlords for increases above the statutory ceiling). Both are embodied in the system of rent regulation (which I use as a generic term) presently in effect in Ontario.

I must emphasize that the nature, scope, and effectiveness of rent regulation varies greatly with the details of the particular regulatory regime in question. Perhaps the most important variables that define a particular system of rent regulation are the following: (i) the level of the maximum allowable percentage increase per period relative to market demand; (ii) the extent and nature of the exemptions from the controls, e.g., new construction after a certain date or when rents rise above $X per month; (iii) the rules concerning increases above the statutory ceiling, i.e., cost-pass-through provisions, allowance for return on new capital improvements etc; and (iv) security of tenure provisions.[13] Note that rent regulation may be used, not to to alter the average level of rents in the controlled sector, but only to prevent the rent on specific units or buildings from being set in a discriminatory fashion substantially above the "going rent" for similar units in the same housing market.

For the purpose of the analysis that follows, it is necessary to assume that, whatever form it takes, rent regulaton is able to set rents below the market-clearing level for at least a substantial fraction of the market, all other things being equal.

5.0 METHOD OF ANALYSIS IN CHAPTERS 2 THROUGH 5

I begin each chapter by describing an argument for some form of rent regulation in the province of Ontario. The list of normative arguments was developed by identifying those used to support the introduction of rent regulation in 1975 by reviewing the academic and professional literature on the subject, and from examining the arguments put forward by the present advocates of the continuation of rent regulation in Ontario. Obviously I could not discuss every possible objective, but I believe that no argument highly relevant to Ontario has been omitted. All three types of normative arguments identified in Stanbury (1985) are represented.

The second stage in the analysis of each normative argument is designed to try to "get a fix" on the particular problem(s) that some form of rent regulation is believed to ameliorate or solve. I try both to define the perceived problem in reasonably specific terms and, if possible, to determine its magnitude.

Third, the analysis explores each argument for rent regulation in more detail in order to understand it better. What is its internal logic? Upon what assumptions is it based? How does the argument relate to the larger framework for understanding government intervention discussed in Stanbury (1985)?

The fourth step is to examine the efficacy of the proposed solution -- some type of rent regulation -- in achieving the objective, i.e., solving the perceived problem. This requires an assessment of the normative argument and the proposed solution in terms of both logic and theory. It also requires at least a brief examination of the empirical evidence as to the efficacy of rent regulation as it has operated to date in Ontario and -- with appropriate caveats -- what effects it has had in other jurisdictions. Because this is an issue that was not discussed until later in the Inquiry, I touch only very briefly on the evidence of the efficacy of rent regulation in solving the problems to which it is addressed. A more detailed survey of the effects of rent controls in Ontario is found in Stanbury and Vertinsky (1985, Ch. 6).

It should be emphasized that the analysis of the arguments for rent regulation that follows is not exhaustive. Even an exhaustive analysis cannot be used to "rule out" certain normative arguments for rent regulation. There are several reasons for this. First, as to the choice of which norms or values to pursue, the "expert" analyst can only speak as one citizen to another, although he can help clarify the objectives being sought. There is no such thing as expertise in value judgments in a democracy. Second, facts and analysis may not alter strong feelings about "how the world works".[14] Third, seldom do theory and/or empirical analysis provide unambiguous answers. Even when all the facts are in and a careful analysis has been done, an important element of judgment remains. Finally, particular distributive outcomes (in the broadest sense) may for some outweigh considerations of economic costs and the limited efficacy of particular policies. Other, apparently "better", alternatives may well require political decisions that are subject to considerable uncertainty. Therefore, people are willing to keep an admittedly flawed policy in place rather than risk the possibility of not getting a better one to replace it.

6.0 MYRIAD ARGUMENTS FOR RENT REGULATION

It is not hard to find at least a score of arguments for rent regulation. For example, Ault (1981) has compiled a list of arguments from the popular press used to justify rent controls when there is a perceived "housing shortage".

- Rent control protects the poor by redistributing income to low income households.
- Rent control benefits racial minorities, assuming racial groups differ systematically in their incomes.
- Rent control is necessary to stop inflation.
- Rent control is necessary to prevent rent gouging because housing is a necessity, and it is hard for tenants to reduce the quantity of housing services consumed in periods of excess demand.
- Rent control is necessary to stabilize the economic characteristics of a city's population, i.e., ensure that those with modest incomes will continue to be able to find rental housing in the core of major cities.
- Rent control benefits racial minorities by preserving the economic characteristics of a city.
- Rent control is necessary to improve housing quality and reduce the number of slum dwellings (i.e., many tenants live in "slum" units only because they cannot afford higher quality housing; by controlling the price of better units, slum dwellers will be able to move and enjoy better quality housing).

Obviously, this list is not complete and focuses on the United States. In Canada, Jaffray et al. (1975, pp. 33-34) specify the following as the benefits of rent control: lower rents for tenants (less than the free market); security of tenure (prevention of rent gouging); greater opportunities for tenants to organize and to engage in constructive discussion with landlords as anniversary dates of rental contracts will become more uniform in each building; a lessening of the pressures by tenants for collective bargaining with landlords which may be accompanied by rent strikes; and savings to the taxpayer through reductions in income support programs.

Closer to the Ontario situation, Hulchanski (1984, p. 73) argues that "a carefully designed and equitably administered system of rent regulations can achieve the following: (1) improved security of tenure; (2) maintenance of the affordability of the existing rental stock; (3) prevention of a regressive redistribution of income in tight rental markets; (4) mediate conflicts relating to rental tenure". He makes it clear that these ends ought to be pursued and that, "given the feasible range of alternatives....rent regulations do appear to be a most reasonable and practical means of achieving the above four ends." The core of Hulchanski's normative position is that rent regulation can and should be used to prevent some aspects of the rental situation from worsening and to enforce certain basic precepts of justice and equity in the landlord/tenant relationship.

7.0 STRUCTURE OF THIS VOLUME

Chapter 2 of this volume addresses the distributional arguments for rent controls in Ontario. The first argument is that controls are needed to prevent the "gouging" of tenants in periods of excess demand. Second, it is argued that controls help make rental accommodation more affordable for moderate to low income tenants. These arguments are explored in some detail.

Chapter 3 analyzes the argument that rent control ought to be used to create a new right for tenants: security of tenure. As we shall see, security of tenure provisions are also needed to make rent controls effective.

In Chapter 4 I discuss a variety of problems that are said to plague rental housing markets and make them operate inefficiently. In particular, we examine two types of market failures -- imperfect information and transactions costs -- and discuss whether they offer strong normative bases for imposing rent controls.

Chapter 5 addresses the argument that rent controls should be imposed to maintain the balance, diversity, and character of neighbourhoods in the central areas of major cities. It is argued that rent controls can maintain the mix of types of housing, types of tenure, and distribution of households by income level.

Finally, in Chapter 6 we discuss our findings and conclusions from each of the chapters. We also examine some of the issues involved in moving from normative arguments to policy considerations. In doing so, we try to determine what the analyst can legitimately say about normative arguments as an "expert" and what he can say only as a citizen. We also discuss the relationship between economic efficiency and society's welfare.

Notes to Chapter 1

1. For an excellent survey, see Economic Council of Canada (1981).

2. See, for example, Breyer (1982), Noll and Owen (1983), Thompson (1980), Graymer and Thompson (1982), and Wilson (1980).

3. See, for example, Stanbury and Thompson (1982a), (1982b), Economic Council of Canada (1979; 1981), Stanbury (1978), and Doern (1978).

4. One study which reviews the scope and growth of all of these governing instruments concludes that Canada has become a "government-centred society" (Howard and Stanbury, 1984).

5. See, for example, Trebilcock et al. (1982).

6. See, for example, Trebilcock et al. (1981) and Stanbury and Fulton (1984).

7. Stanbury and Thain (1985) prepared a study for the Commission of Inquiry into Residential Tenancies. One of the major purposes was to identify, review and analyze major positive theories of government action. Positive theories and analyses focus on what is, why something has happened, or what the relationship is between cause and effect. The objective of positive theory is to derive testable and potentially refutable propositions about how some aspect of the world works. In the same study the authors undertook an analysis of the social, economic, and political factors that brought about legislation in 1975 to regulate rents in Ontario. While conditions that brought about rent controls have changed in some respects, insights into the policy as it exists today can be gleaned from knowledge of its origins.

8. Chapter 2 of Stanbury (1985) focuses on the desire to improve economic efficiency in the allocation of our scarce resources by government action to eradicate or ameliorate the various market failures that reduce allocative efficiency. The second category of normative arguments is based on the idea that certain types of government action to alter the distribution of income or wealth or consumption opportunities will improve the welfare of society, not to mention that of its direct beneficiaries. These arguments are discussed in Chapter 3. The third group of arguments for government intervention, which are discussed in Chapter 4, does not easily fit into either of the previous two classes -- which is not to say there are not allocative or distributional consequences. This group involves arguments for government action in order to create individual rights and thereby remove certain things from market processes.

9. See the papers in Block and Olsen (1981), a number of which are also found in Rent Control: A Popular Paradox (Vancouver: The Fraser Institute, 1975). See also Staff Study, "Rent Controls in Other Jurisdictions: United States, Great Britain, Europe, Australia, Hong Kong" (Toronto: Commission of Inquiry into Residential Tenancies, 1983, mimeo).

10. See the Staff Study, "Provincial Background" (Toronto: Commission of Inquiry into Residential Tenancies, 1983, mimeo), p. 4. The Staff Study (p. 6) indicates that Alberta, New Brunswick, and Manitoba "decontrolled" in 1979 or 1980 and Saskatchewan did so in part. See also Stratford (1982).

11. Government is also needed to regulate the supply of money.

12. For example, when public utility type regulation was imposed on the telephone industry, it was widely believed that the production and distribution of telephone services was a natural monopoly. That is, unit costs would be lower if only one supplier occupied the field. However, to protect consumers from the monopoly power of a single seller, regulation of rates was necessary. By the 1970s, however, it became apparent that the provision of long distance telecommunications services (with the advent of micro-wave and satellite transmission) was no longer a natural monopoly. See Fuss and Waverman (1981). Therefore regulation which may have protected consumers' interests now served to protect the monopolist from competition to the disadvantage of consumers. What conditions had changed to alter the effects of regulation? Technology had reshaped the conditions under which long distance telecommunications is produced. See also Globerman and Stanbury (1985).

13. The variability in the substantive provisions in various rent control schemes is discussed in Lett (1976, Ch. 4). For a discussion of various models of rent regulation and their significance, see Frankena (1975) and Stanbury and Vertinsky (1985).

14. This conclusion should not be surprising for several reasons: people can disagree about "the facts" themselves; they can disagree about what constitutes authoritative evidence; their logic may not be the logic of others (e.g., the economist's concept of costs is based on opportunity costs, i.e., benefits foregone, while most people think of costs as outlays of money); and finally, psychological research makes it clear that deeply held feelings may be irrational but this does not make them any less real.

Chapter 2

PREVENTING "GOUGING" AND MAINTAINING AFFORDABILITY: THE DISTRIBUTIONAL BASES OF RENT REGULATION

1.0 INTRODUCTION

In this chapter I address two of the most important normative arguments for rent regulation. They are based on a desire to alter the distribution of income, wealth, or consumption opportunities. People have strong ideas about "who should get what". First, it is widely argued that rent controls should be imposed in order to prevent landlords from "gouging" tenants by imposing "unconscionable" increases in rent -- particularly when rents are increased more than the increase in the landlord's costs. As I shall discuss in section 2.2, this argument was the one used by tenant groups and politicians who supported the introduction of rent regulation in Ontario in 1975.

The second distributional argument for rent regulation holds that this form of intervention is helpful in increasing or at least maintaining the "affordability" of rental units for households with modest incomes. Controls, it is argued, can reduce the number of households who have to spend more than one-quarter of their income on rent. Obviously, when the rent-to-income ratio is high the amount of income left to purchase food, clothing, transportation, and other things is more limited. The problem is particularly acute for households with low incomes and/or a large number of children.

With regard to each of these two arguments I examine the concepts underlying them, try to assess the extent of the problem and try to determine the likely efficacy of some form of rent regulation as policy action designed to ameliorate the problem. For this chapter and the three that follow, my principal findings and conclusions are set out in Chapter 6.

2.0 PREVENTING RENT "GOUGING"

2.1 The Argument in Brief

It is frequently argued that some form of rent controls should be imposed, perhaps temporarily, to prevent "exorbitant" or "unconscionable" increases in rent attributable to a disequilibrium in the rental housing market. Such controls are usually justified in terms of the desire to prevent what is perceived as an undesirable redistribution of income that would result from the workings of the market. For example, the Community Review and Research Group (1975, p. 16) advocated that rent controls should be imposed in periods of rapidly increasing rents because they produce "unearned benefits" for the property owner. Controls would "help to counter this inflationary trend", which is, in part, due to "the unfortunate side effects of many public decisions and also the failure of the private rental market". Moreover, landlords were said to reap unearned benefits as a result of "community investment". In their view (1975, p. 22), landlords should not be allowed to "make exorbitant demands on the tenant, far in excess of what is needed to secure them a reasonable profit". As I shall describe in more detail, the main argument for rent controls in Ontario in 1975 was to prevent rent "gouging" or "unconscionable" increases in rents during a period of excess demand. (See also Stanbury and Thain, 1985.) I shall also present some empirical evidence concerning tenants' and homeowners' concepts of fairness in the matter of rent increases.

The Ontario Liberal Party has described the original 1975 legislation as "a temporary stop gap measure...to protect tenants from excessive rent increases". The party identified the following "three essential needs" of Ontario's tenants: protection against excessive rent increases; adequate level and quality of maintenance; and assured security of tenure. The Liberals emphasized that because of low vacancy rates in several areas, rent regulations should continue for two more years "in order to protect tenants against unreasonable or unfair rent increases".[1]

Hulchanski (1984, p. 82) argues that rent regulation should be used to prevent or minimize "redistributive changes deemed to be unfair or unreasonable in a situation in which the market mechanism is not functioning normally". The purpose of controls is to prevent landlords from exercising their market power to earn "excess profits", thereby preventing a redistribution of income from tenants to owners of rental accomodation. Such a redistribution is described as "regressive" because, on average, tenants are less wealthy than landlords. Hulchanski is at some pains to emphasize that the object is not to redistribute income from landlords to tenants ("progressive redistribution"), but to prevent what he calls a regressive redistribution due to unusual circumstances.

Hulchanski (1984, pp. 80-81) argues that one of the rationales of rent regulation is to decrease "the occurrence of sudden, abnormal and 'unfair' rent increases in times of limited rental vacancies, in times of general inflationary pressures on all sectors in the economy, and in times of extreme speculative pressures in the land market and the urban development market". He believes that "since the late 1960s, all three of these conditions have prevailed in many of the larger urban areas". The implication is clear: governments should regulate rents to prevent "sudden, abnormal and 'unfair' rent increases in times of limited vacancies".

2.2 The "Gouging" Rationale in the Origins of Rent Control in Ontario, 1975

The most frequent and apparently most powerful argument used by the advocates of some form of rent control in Ontario in 1975 was that controls were necessary to prevent the "gouging" of tenants or to prevent "unconscionable" increases in rents. This argument was made by tenant groups, the New Democratic Party, the Liberal Party, a number of aldermen in urban centres (particularly Toronto), and even by a few Progressive Conservative candidates in the election campaign ending on September 18, 1975. The NDP actively sought, by means of newspaper ads, examples of "gouging" and publicized some of these during the election campaign in August and September. See Stanbury and Thain (1985) for a detailed history. The following quotations illustrate both the language used and the arguments made for rent controls during the campaign or in the period immediately before it.

(i) Statements by Stephen Lewis, Leader of the NDP in Ontario:

- "All over Metro landlords are raising rents regularly by 20, 25, 30, 35, and 40 percent...It clobbers working families and eats up pay increases" (Toronto Star, September 6, 1975).
- "Landlords ain't shameable. They raise rents because they know they can get away with it" (Globe & Mail, September 6, 1975).
- "Every one earning less than $10,000 a year who lives in this sort of Urban Development Institute apartment building pays an excessive amount of income as rent" (Ottawa Citizen, September 13, 1975).

(ii) Statements by Liberal Party MPs or Candidates:

- A rent review board is needed to end gouging. We can't have people living in the streets" -- Gerald Kirby, Liberal candidate, Ottawa Centre (Ottawa Citizen, September 12, 1975).
- "Tenants in Toronto and other large cities must be protected from exorbitant and unjustified increases" -- Robert Nixon, leader of the Liberals (Toronto Star, September 6, 1975).
- "Tenants are desperate as rents escalate. One of the causes of the rent hike has been the Davis government's on-again, off-again stand on rent control and rent boards. Landlords panicked into getting while the getting was good." -- June Rowlands, Liberal candidate (Globe & Mail, September 11, 1975).

(iii) Statements by Progressive Conservative MPs or Candidates:

- "Tenants are calling all the time with rent increases of 30% or more. What can I tell them?" -- Frank Drea, MP - Scarborough, (Toronto Star, May 22, 1975).
- "People who are looking for an apartment are being gouged by landlords and there is no way they can be protected"--Barbara Greene, PC candidate (Toronto Star, August 29, 1975).
- "The classic economic expectation that high rent returns encourage producers to increase the rental housing supply until the demand is satisfied and shortages eliminated simply does not hold true. Developers deliberately maintain the shortages to keep rents spiralling upward...I'm a businessman and I believe in free enterprise. However, I do advocate government intervention when monopolies and cartels control an industry. Only a handful of developers control the apartment 'market prices' in Metro" -- Mel Lastman, PC candidate and mayor of North York (Toronto Star, April 26, 1975).

(iv) Statements by Local Politicians:

- "The City of Toronto cannot afford to have its citizens live with those kinds of increases. It's just unconscionable to allow that to continue" -- David Crombie, Mayor of Toronto, (Toronto Star, June 6, 1975).
- North York Mayor Mel Lastman won the PC nomination in Armourdale. In his speech he repeated his demand that the Province bring in rent controls to stop "unconscionable rent increases by unscrupulous landlords". Rent increases should be permitted "only if they are justified by way of a reaonable return on the investment" (Toronto Star, June 26, 1985).
- East York Alderman Howard Chandler said action must be taken against "almost criminal rents being charged by some landlords, not all of whom belong to the [Urban Development Institute]" (Toronto Star, June 21, 1975).

(v) Statements by Tenants:

- "Please oh please do what you can for tenants. Please hammer on this situation and help thousands like us. Rents are completely out of hand. Where will it all end? Please help all of us" (Tenants' letter to the Toronto Star, September 9, 1975).
- "Seniors on fixed incomes shocked, frightened. Rents up $40 to $60, old age security increase insignificant. Hundreds of elderly forced on GAINS needing subsidized housing by 1976, 1600 waiting now. Where can we go, what can we do?" -- telegram by "Pensioners Concerned" to NDP Leader Stephen Lewis (Toronto Star, June 6, 1975).

Not surprisingly, landlords and their representatives saw the problem rather differently:

- "Housing is a business and the purpose of a business is to make a profit. I never thought a tenant had any rights beyond paying the rent" -- J.T. Blair Jackson, Executive V.-P., Canadian Real Estate Association (Globe & Mail, September 5, 1975).
- "I'd say half the landlords in Metro are gouging and half are catching up" -- David Kirkup, real estate marketing consultant (Toronto Star, September 6, 1975).
- "We have the privilege to make what the market can bear" -- Somer Rumm, president of the Urban Development Institute, a trade association representing large landlords.

2.3 How Is "Gouging" Defined?

"Gouging" is obviously an emotive word, but what does it mean? Those who use it most forcefully do not define it but we can identify several possible meanings.

2.3.1 Concept 1: "Gouging" may be defined as setting a monthly rent above the prevailing market rent for comparable units. Hazlett (1982, p. 293) notes that "the issue of 'gouging' is noteworthy for its universal condemnation. Even landlord organizations point to the small minority of unscrupulous owners who seemingly exploit their tenants". From the comment that follows, Hazlett (1982, p. 293) implies that "gouging" consists of a rent above the market-clearing level: "No landlord has an interest in raising rents for any existing tenants -- provided they are good neighbors — to a level above the market-clearing price." This form of "gouging", he suggests, would simply call forth additional supply and the benefits to existing landlords would be competed away.[2]

In the concept of gouging, the unfairness element -- which appears to be at the core of the term — seems to stem from the landlord's ability to extract a premium for the immobility of the tenant due to high transaction costs. As I explain in detail in Chapter 4, this ignores the reciprocal nature of such transaction costs, and it ignores the role of competition in reducing the landlord's opportunity to "exploit" the tenant.

This concept of "gouging" does not seem to be implied in the reasoning of those using the anti-gouging argument. Their objection is to the market-clearing price itself.

2.3.2 Concept 2: This concept of "gouging" concerns the relationship between rent increases and the landlord's increases in costs and/or rate of return. In periods of excess demand, even rents below the market-clearing level can produce very high rates of return for landlords of existing buildings. Large windfall gains are possible for the owners of existing buildings. The critical idea here is that because of (i) the low short-run elasticity of supply of rental units (which may be due in part to government regulation[3]), and (ii) the low price elasticity of demand for rental accommodation in the short-run, a modest, unanticipated shift in demand can result in sharp increases in rents if there is already a low vacancy rate. Rents, which have been rising both less than the Consumer Price Index and nominal incomes over the previous few years, suddenly jump substantially. While previous annual increments were 4%; or 5% (or even none at all), they suddenly become 15% or 20%. The strong feelings of unfairness arise because of one or more of the following:

(i) The increase in rents is not attributable to any corresponding increase in the landlord's costs, e.g., heating, taxes, or higher interest rates when the mortgage is renewed. Therefore, the tenant reasons, the rent increase is unjustified. This idea of fairness is widely held by tenants and homeowners as we shall describe below.

(ii) Landlords, it is assumed, were already earning a "decent", "normal", or "acceptable" return prior to the increase -- with the increase they will earn "exorbitant" profits. Moreoever, these are pure windfalls due to a shift in demand. The landlord has done nothing of value to earn them -- he was just lucky. In raising rents, he is taking advantage of the fact that everyone has to "have a roof over their heads". There is no choice but to pay the increase, it is argued.

(iii) It is bad enough to earn excess profits due to the shift in demand, it is argued, but the value of the building will rise steeply in light of the new higher rentals. In other words, the new, higher returns will be capitalized into the price of the building. However, if about three-quarters of the original price of the building was borrowed via a mortgage at a fixed rate of interest, the capital gain to the owner could be several times his original investment. For example, if a building that cost $2 million goes up by 30%, and it was subject to a 75% mortgage, the owner's original investment was $500,000. He can now reap a capital gain of 120% of his original stake. Moreover, he may obtain this gain after owning the building only one or two years. Such windfall gains are seen as not being earned -- and, to add insult to injury, they are taxed at half the rate of ordinary income earned by the "sweat of one's brow".

The hostility to rents that produce such gains may be exacerbated by deep (but suppressed) feelings about landlords and their role in society. First, in a sense, the landlord is a "pure capitalist". He uses financial capital (his own plus borrowings) to provide an intangible service rather than a good. In the eyes of some, he produces nothing new -- he merely puts his money to work. In contrast, the steel worker makes steel that goes into thousands of tangible objects. The farmer grows food and the supermarket makes it conveniently available. The landlord, it is argued, "does nothing", he merely "speculates" on the price of rental buildings.

Second, landlords are assumed by the advocates of rent control to be wealthier than their tenants.[4] Hence, at its crudest, "the rich are ripping off the poor" or those of average income.[4a] Third, land is a unique factor of production and most of the capital gains of landlords have to do with the scarcity of prime land in major urban centres. People who have "inside information" about changes in public transportation systems, and about zoning decisions, can obtain large pecuniary gains, but actually do nothing to increase total output -- so the argument goes.

Fourth, for some of the advocates of rent control, the landlord is the most conspicuous symbol of capitalism and the market system of production for profit -- a system driven by individualistic greed. Such a system is of benefit only to those who are strong, crafty, or have plenty of original endowments (capital or human resources). Rapid price increases, it is argued, always mean a capitalist is benefitting at the expense of the basic human needs of the many. Therefore, any opportunity to discredit the capitalist system by condemning one of its most visible actors should be taken.

One prominent American advocate of rent controls sees them as a step toward the elimination of privately-owned rental housing. The object is to make the market so dysfunctional that it will be taken over by public authorities. Then rents could be determined by political and social considerations. Emily P. Achtenberg (1973b, p. 447) argues as follows: "If housing controls which are necessary to protect tenants serve to expedite the ongoing process of disinvestment by the private sector, then new forms of public subsidization, ownership, and financing must be created to take its place. To the extent that any system of housing controls can facilitate these needed changes in the housing system, its social utility is that much enhanced."

Chester Hartman (1978) argues that "the value of rent control, apart from the progressive income transfers it effectuates, is that it is an immediate gut issue around which people can organize. As they work to improve their own housing conditions, their consciousness is raised about the workings of the housing system; the demands they make on the system as a whole are sharpened.... The issues transcend the individual evil landlord." Hartman, it might be noted, has taught urban planning at Harvard, Cornell, Yale, the University of North Carolina, and at the University of California, Berkeley. More recently, Hartman (1983, pp. 4,5) has argued that "we can no longer allow the extensive profit-taking, or perhaps any profit-taking, on so basic a need as housing.... The profit-oriented housing industry is not interested in cost containment or social goals. ...There is a strong case in and of itself to be made for public and private non-profit housing enterprise."

In much the same vein, we note that The Parkdale Community Legal Services in its booklet Your Rights as a Tenant (July 1976) has argued that "the provision of housing should not be left to the whims of the private developer who builds in order to increase his profits. We get housing mostly as a by-product of the deeds (and misdeeds!) of real estate investors and land speculators." It is argued that the market does not meet the needs of low-income families and senior citizens. Therefore, the booklet argues, "HOUSING IS A NECESSITY AND SHOULD BE TREATED AS A PUBLIC UTILITY" (emphasis in the original). In addition, it is proposed that tenants be given the right to bargain collectively with their landlords.

2.3.3 Concept 3: This concept of "gouging" is based on the repudiation of widely held expectations. Suppose, in real terms or as a percentage of income, rents have been declining over several years. Tenants may well form expectations that this will continue indefinitely in the future. They adjust their other expenditures accordingly, e.g., they may spend more on an automobile, or on travel, food, and entertainment. Then, for whatever reason, rents rise sharply. Expectations are not only unfulfilled, but new negative expectations may be created. Shattered expectations can easily result in the perception that substantial rent increases are "unconscionable" and amount to "gouging". The problem may be worsened if large rent increases come along at a time when other prices are also increasing more rapidly than they have in recent years and where unemployment is also on the increase. This was certainly the case in Ontario in 1975 as we shall describe below.

2.3.4 Concept 4: "Gouging" may be perceived in the case of rent increases as amounting to a form of "catch up". As Hazlett (1982, p. 294) puts it, "what may be concluded about the infamous 'rent gouger' . . . is that he or she must have been a rather charitable soul. . . [therefore], it is not the higher rent that is out of line with respect to current costs [or rents on comparable dwellings], but indeed the previously levied low rent". Sharp increases are often associated with a change of ownership. The new owners may buy precisely because the previous owner was charging substantially less than the market would bear. The previous owner's charity, probably not appreciated at the time by tenants, eventually results in rude surprises later.

2.3.5 Concept 5: The perception of "gouging" may be related to the speed of adjustment to economic change. Owen and Braeutigam (1978) have formulated a positive theory of government regulation based on the idea that people are risk averse and that abrupt, economic change often produces what are seen as unfair results. Therefore, they argue that "regulation exists in order to slow down the rate at which the free market redistributes income, thus reducing market risks by voters" (Owen & Braeutigam, 1978, p. 26). In the case at hand, it appears that people prefer to see their rent increased by 7% every year for six years rather than by 50% once every six years--even though the two are roughly equivalent for those who continue to live in the same unit.[5] Therefore, in the face of an apparent need to adjust, particularly to rising prices, or falling incomes, people "look for a break" and want the changes to occur more slowly than the market would do so if left alone. The feeling of unfairness or "gouging" is almost certainly greater if people (tenants) believe that the new, higher prices (rents) are not "justified" by higher costs. But even if they are, they expect someone else (e.g., the landlord) to bear part of the cost during a transition period.[6]

I note in passing that this "give me time to adjust" concept of "gouging" is not symmetric. No tenant organization has argued that rents should be kept up in the face of high vacancy rates (e.g., in the city of Victoria in the summer of 1984) so that landlords will continue to be able to cover their cash costs. Landlords are expected to bear all risks of "gluts" of rental units while tenants expect to have someone else (landlords) help to bear the burden of sharply rising costs and/or increases in demand.

2.4 Perceptions of Fairness in Rent Increases

It is clear that the phrases rent "gouging" and "unconscionable" increases in rent reflect what tenants (and perhaps others) feel is fair in the determination of increases in rents. A study prepared for the Commission of

Inquiry into Residential Tenancies surveyed over 500 renters and homeowners in the Toronto area by telephone as part of a larger survey of attitudes concerning non-pecuniary values and the importance of fairness considerations (Knetsch et al., 1984).

The questions posed by the researchers and the responses are set out in Table 2-1. What does the survey tell us? First, the data indicate that both tenants and homeowners have fairly similar ideas of fairness concerning rent increases under varying circumstances, although in each case a higher fraction of home-owners side with the landlord's position. Second, a very high percentage of tenants believe that landlords should not increase rents under two conditions: (i) where there is an increase in demand, but no comparable increase in costs (Q8); and (ii) where it is legal to raise rents but the landlord's costs have not increased by as much as the allowable rate of increase (Q4). These findings suggest that the second concept of "gouging" discussed above is what most people have in mind when they use the term.

Three-quarters of renters and six out of ten homeowners think that landlords should not increase the rent where there is a change of tenants during a "rent year" -- even if the new tenant is willing to pay the higher rent (see Q6). The responses to this question and those to Q8 suggest that the majority of tenants have a concept of fairness that is different from that which appears to be implicit in uncoerced exchange. Most economists see such exchanges as beneficial because it is assumed that neither party will engage in the process unless they are made better off in their own estimation. What is unfair in the situation where the prospective tenant is willing to pay a higher rent (Q8) and the landlord is willing to let the unit at that rent? If each is not made better off as a result of the exchange why would they make it?

Rent control in Ontario makes provision for landlords, with the approval of the Residential Tenancies Commission, to "pass on" increases in their costs that

Table 2-1

Tenants' and Homeowners' Concepts of Fairness in Rent Increases

The landlord owns a building with five units and charges $400/month rent each; should the landlord	Percent Answering "Yes"		
	Renters	Home-owners	Total
1. pass on increased operating and maintenance costs due to inflation and increase rents by $50/month per unit?	46% n=69	60% n=86	54%
2. pass on increased interest costs when forced to renew his mortgage by raising rents $50/month?	49% n=79	56% n=79	53%
3. temporarily cut back on services if he cannot at present legally raise rents even though his operating costs have increased substantially due to inflation?	25% n=56	37% n=102	33%
4. increase rents by the legally allowed maximum of $50/month which reflects general cost increases, although the tenant can show this landlord's costs increased by less than this amount?	10% n=86	26% n=85	18%
5. set the rent of identical units in a newly built wing of the building $50/month higher than the older units to reflect the higher costs of building the new units?	46% n=79	65% n=82	55%
6. increase the rent of a unit just vacated by $50/month even though the rent was raised 3 months ago and would not normally be increased for 9 months, but where the new tenant is willing to pay the higher rent?	24% n=80	41% n=79	32%
7. increase rents by $50/month reflecting his increase in costs even though several of the present tenants will be forced to move?	54% n=76	64% n=78	59%
8. increase rents by $50/month, reflecting general increases in rents due to people moving into the area to work at a new factory?	15% n=67	32% n=89	25%

Source: Knetsch et al. (1984, pp. 21-23).

exceed the annual statutory increase (now 6%). Just over one-half the sample believed that increases in operating and maintenance costs and mortgage interest costs *should* be passed on to tenants. See Q1 and Q2 in Table 2-1. Why is the percentage so low? One explanation is that of pure self-interest: people think it is unfair that *they* should pay higher prices, period. The fact that the seller's costs have increased is irrelevant. This argument is easier for the tenant to make if he has latent feelings of hostility to landlords. Another possible explanation is that the tenants believed that landlords were already doing "too well" (e.g., earning excess profits) so they should be made to absorb the increases in costs, not their tenants. Again, if tenants are hostile to landlords this rationalization may be easier to adopt.

We note that more people (67%) think that the landlord should *not* temporarily cut back on services in the face of rising costs than feel he should *not* increase the rents for the same reason (46%). Compare Q3 to Q1. *A priori*, we would have believed that the reverse would be the case, namely that more people would be opposed to rent increases, which entail a cash outlay, than to a cut back in services, as the latter is less likely to be noticeable or felt as keenly. Perhaps tenants feel that is easier for the landlord to "cheat" and to save more on reduced services to offset the other costs that have increased.

It appears that tenants and homeowners see the higher costs of new construction (Q5) as no greater justification for rent increases as they do higher operating costs (Q1 and Q2). Can one infer from this result that as many as one-half of all tenants do *not* approve of the idea that buildings constructed after the imposition of rent controls in 1976 in Ontario are *exempt* from rent control? Investors will require higher rents on new buildings to reflect their higher cost.

Finally, we should note that the majority of tenants and homeowners find it acceptable for a landlord to increase his rents to reflect his increases in costs even where some of the present tenants will have to move out because they can no longer afford to pay the rent (Q7). Knetsch et al. (1984, p. 24) conclude that

> the norms of fairness that govern the landlord's behaviour are not norms of charity, which would presumably be controlled by considerations of the renter's need.... The norms that people apply appear to be impersonal rules, which focus on the rights and obligations of responsible economic agents, rather than on a sentimental response to individual pain or discomfort.

They continue,

> According to the general norm the tenants have the responsibility of choosing accommodations that are within their means, and the landlord is not expected to protect them from the consequences of mistakes. The tenant's responsibility probably extends to the prudent avoidance of foreseeable risks, including the risk of legitimate increases in rent.

We can suggest another interpretation of these data. It is that the majority of the respondents are middle class individuals who perceive that questions 1 to 6 and 8 are likely to apply with more force to them, while Q7 is seen to apply to someone else. In short, they are "looking out for number one". The boundaries of their concern appear to be fairly limited.

2.5 The Demand for Temporary Controls

It is easy to understand how controls designed to prevent "unconscionable increases" in price come about. According to Thurow (1981, p. 141), they "are almost always instituted to prevent some dramatic price increases that threaten to cause major reductions in the real incomes of some group".[7]

As we have noted, Owen and Braeutigam (1978) propose a positive theory of regulation based on the idea that most individuals are risk averse and seek to protect their present economic position by government action designed to reduce the speed and extent of economic change. Economic change can produce significant shifts in the income and wealth of particular individuals or groups. Regulation, they argue, uses an administrative decision-making process to produce outcomes that are perceived as "fairer" than those produced by an unfettered market. In effect, government intervention gives some individuals some legal rights to the maintenance of the status quo. The empirical work of Knetsch et al. (1984) indicating the widespread strong aversion to losses reinforces the argument of Owen and Braeutigam.

In terms of their impact on allocative efficiency, temporary controls are least objectionable when they don't distort the signals embodied in rising prices. This general point is emphasized by Hayek (1976, p. 80) when he reminds us that the role of prices of all types in a market system is not to act as a reward but to act as signals "to indicate to people what they ought to do if the (spontaneous) order is to be maintained on which they all rely".[8]

Thurow (1981, p. 141) explains when temporary controls may be desirable for distributional reasons and when they will have the least adverse effects on allocative efficiency.

> If the situation causing the rapid escalation in price is temporary, a crop failure for example, then there may be a case for preventing a sharp temporary shift in the distribution of real income. Extra price incentives are not necessary to restore production in agriculture, and industrial wages might be disrupted if agricultural prices were allowed to rise.

There is another case, namely where the supply that would normally be called forth in response to rising prices is deliberately restricted in order to redirect resources to what are deemed to be more important uses. We refer, of course, to wartime situations. Here the authorities appreciate that in some areas, near war plants, there will be excess demand for housing. However, if prices were allowed to rise, scarce resources (labour and materials) would be drawn away from more critical needs, e.g., armaments. Therefore, in this case both efficiency and distributional considerations are served by the same policy.[9]

Clayton Research (1984, p. 31), noting the long lead time involved in producing new rental units, argues that the lengthy supply-response period "could give landlords an opportunity to take advantage of excess demand by imposing excessively high rent increases during the period prior to the provision of new supply". This point provides support for the argument that temporary controls may be necessary to prevent "gouging".

Presumably the clearest case on equity grounds for temporary controls to prevent rent "gouging" would occur under the following conditions/assumptions:

(i) there are widely-held views that income/wealth should not be redistributed from tenants to landlords (except as that which might occur under a long-run competitive equilibrium); and

(ii) there is a disequilibrium situation in the rental housing market such that rents in the short run would rise sharply, but such increases are not attributable to real cost increases (but are largely demand related); and

(iii) there are widely held views that it is fairer to ration the excess demand for rental units by queues, increased search costs, "under the table" payments, or by some form of political or administrative decision making than by the price system.

Several points should be noted here. First, redistributing income or wealth from landlords to tenants is not the same as redistributing income/wealth from the rich to the poor. True, some landlords are wealthy, and true, a considerable fraction of all tenant households fall into the bottom quartile of the income distribution. The point is that most of the beneficiaries of rent controls that really do hold rents below the market-clearing level are middle-class, middle-income families. Moreover, data prepared by the Ontario Ministry of Municipal Affairs and Housing (1982) indicate the following facts about landlords and the rental housing stock in Ontario: in the 10 Census Metropolitan Areas in Ontario as of March 31, 1981, some 274,915 of a total of 812,675 rental buildings contained five or fewer units. A survey of buildings with six or more rental units (covering 40% of the total rental stock) found that in 1980 some 81% of landlords (n=5778) owned only one building. Two-thirds of these owners were individuals, husband and wife teams, or partnerships. The owners of only one building accounted for 48% of the total number of rental units in the same survey of 435,174 units.[10] The fact is that a large fraction of all landlords run either a "mom and pop" operation or what could only be described as a small business. But even if that is not the case, by what reasoning does it follow that the owners of one particular type of business enterprise (rental housing) should personally subsidize their customers? Do we expect the owner of the neighborhood Mac's Milk -- another small businessman -- to sell milk and bread to poor families at a lower price than he does to his other customers who drive a Cadillac?

Second, it should be apparent that rent control is an extremely crude form of government action if its purpose is to redistribute income to low-income households or those that are deemed to have an "affordability" problem. See Marks (1984), and Fallis and Smith (1985). For example, while controls may keep rents for the poor below market-clearing levels, many more non-poor families will benefit than poor families. Moreover, rent controls make poor households worse off if they were not tenants when controls were first imposed. They have to incur larger search costs to obtain a controlled unit, they may have to pay "key money", or they may be forced to purchase a home and involuntarily consume more housing services than they want.

Third, some of the advocates of rent controls believe strongly that rental housing is too important and basic to every family to be treated as a commodity with its allocation determined solely by market forces. Rather, political and/or administrative decision processes should be used to constrain or supplement market forces in order to ensure a "fairer" allocation of rental housing.

But are non-price methods of allocation "fairer" than allocation by price? While the latter depend upon both willingness to pay and ability to pay (i.e., income or wealth), non-price rationing rewards persistent search behaviour,[11] contacts, and political "smarts" where access to rental units is controlled by a government agency. Where any good or service is in excess demand and price-bidding is ruled out, the supplier has discretion to determine who will get what is available. The way that discretion is used may not be in accord with the values of those persons subject to it.

The economic cost to society of meeting these equity goals will be less where

(i) for whatever reason, the relative shortage of supply will not be adversely affected by the fact that rents are controlled;

(ii) the period of excess demand (disequilibrium) is virtually certain to be temporary, hence rent control will not alter long-run supply. (Indeed, short run controls that prevented a substantial and almost immediate jump in supply [if that were possible] could avoid excess capacity in the near future when the "crisis" is over.) One need hardly remind readers of the fallibility of forecasters, both economists and non-economists. Or

(iii) it is public policy to try to prevent an increase in the supply of rental housing that would normally be called forth (in time) by rising rent, e.g., war time.

2.6 Problems in Removing Temporary Controls

Arnott (1981, p. 30) argues that when it is desirable to impose rent controls, they should be temporary and imposed in response to some unusual set of circumstances. The inefficiency costs associated with rent control increase more than proportionately to the time controls are in place or are widely expected to be imposed.

However, even if short term controls are justified by a severe disequilibrium that would produce rent "gouging" that would result in an undesirable redistribution of income, decontrol can pose a serious problem. As Robbie Burns reminds us, "the best laid plans o' mice and men gang aft agley". Arnott (1981, p. 31) concludes that "because rent controls can for political reasons, prove difficult to remove, it may be better not to introduce them at all.".

The reasons that rent controls (indeed almost any type of price controls) are hard to remove are not hard to understand. The core of the explanation lies in the fact that even if regulation was not introduced in response to interest group pressures (see Stanbury and Thain, 1985; and Hartle, 1984), it creates interests in its perpetuation. This occurs because regulation -- unless it is purely "for show" -- alters the allocation of resources and hence the distribution of income. As Noll and Owen (1983, pp. 9-10, 12) remark, "regulation itself can create or reinforce interest groups and...it is possible to make predictions about which groups affected by regulation are likely or unlikely to coalesce into effective interest groups". They emphasize that "regulation can create interests in the perpetuation of regulation even where none existed before".

Moreover, regulation is often designed to alter the distribution of income/wealth that would occur if the market was left alone -- see Stanbury and Lermer (1983), and Cairns (1985). Therefore, the beneficiaries of regulation will fight to keep it in place. Even those who are not major beneficiaries may prefer regulation to continue because they have adapted to it and don't want to bear the costs of further change. Recall the old adages, "an old tax is a good tax", and "the devil you know is better than the one you don't".

It should be recalled that the personal income tax was introduced in Canada during World War I as a "temporary measure". Similarly, rent regulation was enacted in Ontario as a temporary measure. Some type of rent regulation was proposed by the Ontario Progressive Conservatives during an election campaign in July 1975 in response to the stronger promises of the NDP and the Liberals. The legislation was enacted in December, retroactive to July 29, 1975. It was to remain in force only until August 1, 1977. In other words, the original legislation had a built-in "sunset clause". Not only was the legislation extended, but the system of controls became substantially more elaborate and complex.[12] In any event, the original two-year measure will soon be nine years old and there is no sign that the regulation of rents will be discontinued. For example, all three political parties favour some form of rent regulation. The Commission of Inquiry into Residential Tenancies, commenting upon its terms of reference, has specifically stated that

> it is quite clear that the policy of the Government of Ontario is to continue with some form of rent review. The Commission is not directed to look into rent review. The Commission is not directed to look into the pros and cons of that policy. Delegations [appearing before the Inquiry] concerned with whether or not there should be rent review would be out of place.[13]

The difficulty, therefore, is that a useful and widely supported temporary measure designed to overcome a fairly short-term problem will be impossible to remove -- even after the conditions that brought it about have changed. This is certainly the case in Ontario.

As we have noted, policies in place create interests in their survival. These interests need to find new and compelling reasons that can be publicly articulated and that are not inconsistent with the new circumstances that exist. For example, while vacancy rates were still fairly low in most Ontario cities in 1984 and 1985, (although they are much lower in the controlled sector than the uncontrolled sector), the general inflation rate in 1984 and 1985 was less than one half what it was in 1975. Unemployment, however, in 1984 and 1985 was several percentage points above what it was in Ontario in 1975. See Stanbury and Vertinsky (1985, Ch. 6).

2.7 The Nature of the Problem in 1975

As we have noted above, the central argument for the imposition of rent controls in Ontario in 1975 was that they were necessary to prevent rent "gouging". What was the nature and extent of the problem that underlay the proponents' arguments? Stanbury and Thain (1985) provide some information on rent increases in Toronto as follows:

> Despite the fact that the City of Toronto's population declined by 11.1% between 1971 and 1976, low vacancy rates put pressure on rents.[14] The data reported in Table [2-2] were collected by Canada Mortgage and Housing Corporation in the Toronto CMA for vacant units in buildings of six or more units. These buildings make up a substantial fraction of rental stock in Toronto.
>
> We can summarize these data by looking at the range of increases in rents for the four sizes of rental units over the 6 and 22 months preceding October 1975.

	increase Dec.'73 to Oct.'75	increase April '75 to Oct.'75
City of Toronto	22.6 to 39.2%	-2.1 to 10.6%*
Etobicoke	23.1 to 52.8	4.3 to 25.4
Scarborough	28.1 to 35.1	4.4 to 12.5
York Borough	26.5 to 28.9	-11.5 to 5.4
East York	16.6 to 45.5	-14.3 to 13.4
North York	27.6 to 36.0	27.6 to 36.0
Mississauga	18.1 to 34.0	18.1 to 34.0

> * range depends on the size of the unit
>
> In the City of Toronto, depending on the size of the unit, rents increased between 22.6% and 39.2% between December 1973 and October 1975. In Etobicoke, the increases were even higher, 23.1% to 52.8%. Overall, it appears that rents in the Toronto CMA increased by at least 20% and in some cases by over 40% in the 22 months preceding October 1975.

Stanbury and Thain (1985, Ch. 5) continue:

> The rate of increase during the period April to October 1975 varied enormously by size of unit and by area. In fact, average rents decreased for some types of units in three of the seven areas measured in the Toronto CMA. At the other end of the spectrum, rents in North York increased by 27.6% to 36.0% in the six months ending in October 1975.

Table 2-2

Rent Increases in the Toronto Area, December 1973 to October 1975*

Specific Area	** size	Percentage Increase in Rent for the Six Months Ending				% increase Dec/73 to Oct/75	Average rent in Oct/75($)
		June/74	Dec/74	April/75	Oct/75		
City of Toronto	ba	4.6	2.5	15.6	10.6	30.9	199
	1b	3.9	12.8	10.6	11.0	39.2	252
	2b	-8.1	13.3	20.9	2.8	22.6	331
	3b	-4.6	32.5	4.8	-2.1	27.6	412
Etobicoke	ba	n.a.	n.a.	20.4	10.7	23.1	176
	1b	41.8	12.0	-21.0	4.3	42.5	218
	2b	1.7	6.2	15.3	9.9	30.8	310
	3b	5.6	6.3	12.7	25.4	52.8	434
Scarborough	ba	n.a.	n.a.	n.a.	n.a.	n.a.	187
	1b	7.3	11.7	2.9	4.4	28.1	214
	2b	12.2	24.6	-11.4	4.5	35.1	254
	3b	15.5	2.8	2.1	12.5	35.5	332
York Borough	bc	0.7	21.9	0.9	3.0	27.2	173
	1b	7.1	12.7	0	5.4	27.2	215
	2b	10.0	12.7	5.4	-1.6	26.5	253
	3b	15.1	15.4	14.6	-11.5	28.9	295
East York	ba	7.3	5.6	-14.0	13.4	16.6	176
	1b	10.7	3.6	13.3	8.1	35.0	239
	2b	36.0	-1.4	12.0	-0.3	44.4	309
	3b	n.a.	n.a.	-5.7	-14.3	45.5	432
North York	ba	n.a.	n.a.	n.a.	16.1	n.a.	173
	1b	4.0	18.8	-7.0	11.0	27.6	222
	2b	8.7	28.8	4.4	-0.4	35.4	264
	3b	16.5	18.9	16.5	-11.6	36.0	321
Mississauga	ba	6.5	0	10.9	0	18.1	163
	1b	6.3	32.0	0	-4.5	34.0	213
	2b	5.2	72.9	6.4	-33.3	26.4	244
	3b	-1.3	76.1	-4.4	-25.7	25.3	292
Remainder of Toronto CMA	ba	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
	1b	8.2	9.4	2.4	16.8	36.1	215
	2b	8.7	3.0	26.9	3.7	35.9	250
	3b	-8.4	27.1	-2.7	5.5	20.6	287

* All figures are based on vacant units in privately initiated buildings, new construction, and existing buildings containing 6 or more rental units. The survey covered more than 200,000 units, but CMHC states "no attempt has been made to adjust to the total universe, the figures shown are not necessarily representative of the private rental market as a whole".

**ba = bachelor suite; 1b = 1 bedroom unit; 2b = 2 bedroom unit; 3b = 3 bedroom unit.

Source: Surveys conducted by Canada Mortgage and Housing Corporation, Toronto regional office.

Table 2 - 3

Rent Component of the Consumer Price Index For Three Ontario Cities, 1971 - 1975

1971 = 100

Date	Ottawa	Toronto	Thunder Bay
1971 Jan.	99.3	99.3	99.4
June	99.9	99.8	100.1
1972 Jan.	100.9	100.7	100.1
June	101.5	101.3	102.3
1973 Jan.	103.9	102.1	104.2
June	104.6	102.8	107.4
1974 Jan.	106.4	104.1	112.3
June	108.0	105.2	117.7
1975 Jan.	110.8	108.9	120.4
June	111.9	111.4	123.4
Dec.	115.4	116.0	129.1
total increase over 5 years	16%	17%	30%

Source: Statistics Canada, Cansim data base D486533, D486783, D487033, rent component of the Consumer Price Index.

> The accuracy of these data is impossible to ascertain. It is possible that rent increases for vacant units (as collected by CMHC), being the price of units at the margin, were substantially above those for the stock as a whole, i.e., the average increase in rents. The increases reported in Table [2-2] for 1975 seem extremely high when compared to other data on rent increases in Toronto. For example, the Community Review and Research Group (1975, pp. 5-6) reported the following average rent increases in 1975, based on limited surveys:
>
> - 14.2% - 18.2% (Urban Development Institute);
> - 17% (Metro Tenants Federation re North York); and
> - 11.7% for the year ending July 1975 (Ontario Ministry of Housing).
>
> The data in Table [2-2] are also not consistent with Statistics Canada rent indexes for three Ontario cities provided in Table [2-3]. For example, these data indicate rents rose in Toronto by only 17% over the five year period 1971-1975. Rents rose only by 7% during 1975 in Toronto.

It is not enough to look only at the size of rent increases in 1975 or in the previous year or two, although, as we have seen, it is hard to get really satisfactory data on this important variable. Rather, the problem should be seen in a larger context of economic conditions generally, and of expectations. People's perceptions of problems are usually more important than the facts as supplied by Statistics Canada. Stanbury and Thain (1985, Ch. 5) argue as follows:

> In theoretical terms, the demand for political action in light of economic distress can occur in a number of different contexts. First, the distress may be genuine. Large numbers of people may be experiencing a sharp drop in their standard of living attributable to rising prices and/or falling nominal incomes. Second, the economic distress may be more perceived than real, which is not to say that it is any less important for politicians provided the perceptions are strongly held. The gap between perceptions of distress and reality are likely to occur because of sharp changes from recent experience. For example, rents in real terms may have been declining for several years and then experience a sudden jump. Even after the sharp rise, rents may still constitute a smaller fraction of income (for a given size and quality of accommodation) than they did several years earlier, yet tenants feel much worse off because of the sudden change in their immediate circumstances. In some ways, it is the fluctuation in the rate change that is resented more than the same total amount of change over the same period if attained "smoothly".

> There may also be a gap between perception and reality causing feelings of distress because of dashed expectations. "Good times" generally create higher expectations for one's economic future. A sharp increase in rents, particularly in real terms, because housing expenditures are a substantial fraction of income, may be a bellwether that changes expectations in general. This feeling will probably be exacerbated, if, at the same time, a substantial number of people come to believe their economic situation is not advancing as rapidly as that of their reference group. Comparisons are ubiquitous. Even though a person's real income (consumption opportunities) is rising, perhaps as rapidly as the average, he may feel worse off because the incomes of his neighbours, his co-workers, or some other group seems to be advancing more rapidly.

With respect to the larger economic situation, Stanbury and Thain (1985, Ch. 5) state:

> Sharp rent increases were not the only economic factor putting pressure on Ontario's urban households. The general inflation rate was in the double-digit range and rising. The data in Table [2-4] indicate that the Consumer Price Index rose by 10.9% and 10.8% in 1974 and 1975 respectively. Perhaps more importantly, the CPI rose by only 2.9%, 4.8%, and 7.6% in 1971, 1972, and 1973 respectively. In other words, inflation was accelerating. When we examine some of the components of the CPI we find that food prices increased extraordinarily between 1972 and 1975 -- by 7.6% in 1972, by 14.6% in 1973, then by 16.3% in 1974, and then by 12.9% in 1975. Energy prices show a similar pattern beginning in 1973 -- see Table [2-4]. The housing price index, which reflects both rents and ownership costs, actually grew less rapidly than the CPI, food prices, or energy prices between 1973 and 1975. However, the rate of increase was also accelerating, i.e., it was 4.6% in 1972, 6.5% in 1973, 8.7% in 1974, and 10.0% in 1975.
>
> At the same time, unemployment was also rising and the rate of growth of income per capita was slowing. It should be noted, however, that Ontario's average annual unemployment was about one percentage point lower in 1973 and 1974 than it was in 1971 and 1972. In 1975 it increased to 6.3% -- slightly below the national average of 6.9% that year, but well above the rate of 4.4% in 1974. The impact of the change in labour market opportunities in Ontario is better indicated by the change in the help-wanted index. As Table [2-4] indicates, this index which increased by 14.1% in 1974, fell by 32.4% in 1975.

Table 2-4
Selected Economic Indicators, 1971-1975

Economic Indicator	1971	1972	1973	1974	1975
. % change in *real* Net National Income per household	4.9	5.2	7.3	4.5	0.0
. % change in personal income per capita in Ontario (current $)	8.5	10.9	13.1	15.9	12.9
. average annual wage changes in major collective agreements - without COLA - in manufacturing (%)	n.a.	9.6	12.2	16.1	16.4
. % change in Consumer Price Index	2.9	4.8	7.6	10.9	10.8
. % change in housing price index	4.5	4.6	6.5	8.7	10.0
. % change in food price index	1.0	7.6	14.6	16.3	12.9
. % change in energy price index	n.a.	2.8	9.0	15.2	13.5
. Interest rate on 5-year conventional mortgages (%)	9.43	9.21	9.59	11.24	11.43
. Unemployment rate in Ontario (%)	5.4	5.0	4.3	4.4	6.3
. % change in the help-wanted index in Ontario	-3.6	46.3	27.4	14.1	-32.4
. % change in output per person employed	4.8	4.0	3.7	0.4	-2.6

Source: Department of Finance, *Economic Review, April 1983* (Ottawa: Minister of Supply and Services, 1984).

> While the unions were able to gain large wage increases, over 16% in 1974 and again in 1975 in manufacturing, productivity (in terms of output per employed person) increased more slowly from 3.7% in 1973 to only 0.4% in 1974 and actually fell by 2.6% in 1975. The rate increase in nominal per capita income in Ontario in 1972 and 1973 was double the increase in the CPI. The rate of increase in real per capita income declined in 1974 and again in 1975 to about 2%. So while things were improving in 1975, they were improving at a far slower rate than they did in 1973 and 1974 when real per capita income in Ontario increased by about 5%.

2.8 Concluding Comments on Rent Controls and Rent "Gouging"

If the CMHC data on rent increases cited in Table 2-2 are correct, then rents rose in 1974 and 1975, at between two and three times the increase in the Consumer Price Index. As we noted, Statistics Canada data, reported in Table 2-3, indicate that rents in Toronto rose substantially less rapidly than the CPI in 1974 and 1975. Research by Stanbury and Thain (1985) makes it clear that there was a wide spread perception (among tenants' organizations, local and provincial politicians and reflected in hundreds of newspaper stories) that rents were rising faster than the rate of inflation in 1975 and that the rate of inflation itself was accelerating.

Calls for rent regulation, which began in the spring of 1975 and which became more intense during the election campaign in August and September, were based on the argument that rent increases amounted to "gouging". The economic facts were consistent with a conclusion of "gouging" based on the following rationales: (i) rents were rising faster than landlord's costs (although energy prices were rising rapidly in 1975 and interest rates were also rising to reflect the general level of inflation), hence landlords were believed to be making excess profits and/or windfall gains as the value of their properties increased; (ii) rents were rising in 1974 and 1975 (according to the CMHC data) much more rapidly than they had in the previous few years. Therefore, expectations about declining rents in real terms or a declining ratio of rent to income were brutally thwarted.

The fact is that renters in the late 1960s and early 1970s were finding it easier to write the monthly rent cheques as their incomes rose and rents increased more slowly than the CPI. When this trend was reversed and there was some evidence that landlords were able to increase rents well in excess of their increased costs, renters sought refuge in government action to control the rate of increase of the largest single payment they made every month.

The background to rent controls in Ontario needs to be sketched more fully. First, over the past decade renters had become a larger fraction of all households in Ontario, particularly in Toronto. Second, during the 1975 election campaign all three political parties engaged in a "bidding war" in offering proposed rent control policies. Reluctantly, the party in power, in a series of announcements, moved from being opposed to any type of controls to offering to implement a system to prevent rent gouging -- see Stanbury and Thain (1985). Third, there were well-publicized examples of large rent increases levied on the most vulnerable -- those with fixed incomes (e.g., pensioners), and those with low incomes and large families. In effect, the vast majority of tenants who were not poor and most of whom had rising incomes were able to advance or protect their own economic position behind the banner of protecting the disadvantaged. Fourth, the general economic environment was filled with uncertainty: both the rate of inflation and unemployment were rising. People were searching for an anchor in a storm-tossed sea. Rent controls seemed to offer an attractive solution -- one that would slow the pace of rent increases and make them more predictable.

Rent controls such as those implemented in Ontario in 1975 and subsequently modified can, and probably have, sharply reduced the incidence of "gouging" that takes the form of almost pure demand-related increases in rent. Such controls do prevent large increases in rent that are not "cost-justified". They can prevent a redistribution from tenants to landlords in the periods of excess demand. Whether this ought to be done, obviously, is a value judgment. However, we have seen that it is one that appears to be held by the majority of tenants and homeowners in Ontario (Knetsch et al., 1984).

In the short run, where there is very low elasticity of supply, even large increases in price do not produce much increase in output. Therefore, the short run allocative distortion caused by price controls is minute. The problem for allocative efficiency arises in the longer run when the elasticity of supply is greater. Rent controls suppress the price and profit signals that provide the bright green lights for investors to commit their funds to new rental buildings. Allegedly temporary controls are hard to remove even when the economic circumstances that brought them about change a great deal.

Posner (1969) has remarked that many people prefer to pay $1.10 for an article of which $1.05 consists of costs to paying $1.00 for the same article of which 85 cents consists of the producer's costs. In other words, they focus on the profit received by the seller rather than the amount they themselves pay for the good. They seem to be minimizing their "opponent's" position rather than maximizing their own.

Where a system of rent controls (i) seeks to keep the landlord's average rate of return down; (ii) allows rent increases justified by higher operating costs; and (iii) implicitly offers a high incremental rate of return on certain types of cost expenditures (usually capital improvements), there is a danger that they can produce a type of Averch-Johnson effect.[15] In other words, certain costs may be incurred because it is profitable (at the margin) to do so under the controls (and where excess demand exists) -- even though the marginal benefits as perceived by tenants are less than the incremental rent they must pay (or move). By focusing unduly on costs in an effort to prevent tenants from being "gouged", the regulators may, in some instances, make the tenant worse off than he would otherwise be.

Other findings and conclusions are discussed in Chapter 6. We move now to the second distributional basis of rent regulation, affordability.

3.0 AFFORDABILITY

It has been argued that rent regulation should be used to ensure affordable housing for all but particularly for those families with a low income. As Steele and Miron (1984, p. 1) put it, "there is a general view that people have a right to housing, that 'the right to housing' means not just the right to shelter, but more, and one part of that 'more' is that housing should be affordable." The argument is that rent controls, by keeping rents below the market-clearing level (at least in the controlled sector), particularly with the passage of time in the face of persistent inflation, will reduce the ratio of rent to income. Therefore, low income households will be able to either consume more or better housing services and/or have more income after they have paid their rent with which to purchase other goods and services.

3.1 The Nature of the Argument

Marks (1984b, pp. 45-46) is one of the few writers to actually specify the logic of using rent regulation to address the problem of housing affordability. He puts it this way:

(1) Affordability is determined by comparison between a household's housing costs and its income to the ideal relationship.

(2) A household has an affordability problem if its housing costs are too large a part of income after making various adjustments [such as those designed to reflect relative prices; adjustment for quantity and quality substitution; distinguish between current versus permanent income; and reflect differences in relative prices by location].

(3) Rent regulation moderates rises in housing costs in the covered [rent controlled] part of the rental housing market.

(4) Therefore, rent regulation reduces the affordability problem, in that a household's housing costs are kept below what they would have been in the absence of regulation.

A variant of this argument is offered by Hulchanski (1984, p. 81), who states that "rent regulations do not and cannot lead to the supply of additional rental housing, especially affordable housing. Nor can they necessarily 'alleviate' housing affordability problems." However, he does claim that "second generation" controls such as those in operation in Ontario can "prevent the existing stock from becoming increasingly unaffordable" (Hulchanski, 1984, p. 81). This is done by slowing down the rate of increase in rents that would occur in the absence of controls. The permitted rate of increase is not based on demand pressures, "but on other non-market criteria, such as operating costs" (Hulchanski, 1984, p. 82).

In her review of the legal strategies for protecting low-income housing in the United States, Florence Roisman (1983) gave little emphasis to the use of rent controls to ensure the availability of affordable housing. She focused on three principles: preserving the existing stock of housing available to poor people; increasing the stock available to poor people; and prohibiting the forced displacement of poor people from existing housing. Roisman advocated large-scale federal subsidies, "because it is right to do so", in that most low-income families are not able to secure decent housing on their own. Moreover, "basic fairness", she argues, requires such subsidies in light of the extensive tax subsidies the American federal government provides for middle and upper income families in the form of the deductability of mortgage interest in computing taxable income.[16]

Roisman (1983, p. 91) argues that "governments can [and should] exercise substantial control over private housing to dedicate at least some significant portion of it to low-income use. Rent control is an important part of such an effort: at the least, landlords should not be permitted to raise rents unless they can justify doing so." She goes on to say that "eviction control is a crucial part of rent control: tenants must be secure in their tenure unless the landlord can prove a particularly good cause for eviction".

Implicit or explicit in the argument for rent controls to increase the supply of affordable housing, particularly for low income families, is that housing is a basic human need and that "decent, affordable housing" is a right. Before we explore the techniques used to measure the affordability of housing and to estimate the number of households who have an affordability problem, we discuss this line of argument.

3.2 Basic Human Needs and the Right to Affordable Housing

Housing should be a right, in Davidoff's (1983, p. 189) view, because "safe and sanitary housing is a basic human need. Along with food and clothing, it is essential to survival.... It could be argued that access to decent housing is more important than access to decent health care and education." However, he argues, it should not be necessary to choose among the three. From Davidoff's (1983, p. 189) position, justice and fairness support the contention that "it is wrong to impose on any household the necessity of living in indecent shelter". The affluence of the nation also provides the means to substantiate the claim in his view.

Davidoff (1983, pp. 186-7) advocates that "decent housing for all" be elevated from a goal to a legal entitlement. This is part of a three-part proposal that also includes devoting more resources to housing so as to expand the economic well-being of lower-income housholds and establishing a legal right not to be removed from a preferred place of residence. For him, these are but logical extensions of the United States 1949 Housing Act, the goal of which was "the realization as soon as feasible of the goal of a decent home and suitable living environment for every American family".[17]

Fallis (1984, p. 25) argues that affordability of housing is not itself a fundamental social value which can be used to justify government intervention. Rather it is "a proxy for several fundamental values -- that people are entitled not only to adequate housing but also to adequate medical care, clothing, food, education, and so on". He notes that affordability should not be confused with adequate housing -- the idea that everyone, regardless of their income, "should have housing that is clean, dry, properly heated, and in a good state of repair; that has hot and cold running water and indoor plumbing; and that is not overcrowded" (Fallis, 1984, p. 22). The heart of the affordability problem, therefore, appears to lie in the argument that if households spend more than a specified fraction of their income on housing there will not be enough money left over to purchase "adequate" amounts of other goods and services, some would say "necessities".

Fallis (1984, pp. 28-9) concludes, however, that even with a more sophisticated approach to measuring it, "the concept of affordable housing itself is not a fundamental social value and should not be used in considering the rationale for rent regulation or in assessing the effect of rent regulation". Rather, the fundamental value -- which does justify government action -- is the entitlement to "adequate amounts of other necessities such as food, clothing, so on".

Steele and Miron (1984, pp. 4-5) don't agree and offer two reasons why the rent-to-income ratio should be of greater concern to policy makers than that of food expenditures to income, for example. First, expenditures on housing are relatively fixed and are difficult and expensive to adjust when circumstances change.[18] It is not easy to reduce the quantity or quality of housing services when income falls or the price of housing increases as it is for other goods and services. Second, Steele and Miron argue, for those with low incomes, low-rent housing "may simply be unavailable in some circumstances", particularly for large families. Moreover, building codes and zoning regulations may place a fairly high cost "floor" on the quality of rental housing of recent vintage. Older buildings, however, may meet the demand for low-rent housing at the expense of poorer quality.

Block (1981, pp. 300-01) argues strongly that housing is not a basic human right. He notes new types of positive rights have been claimed: "everything from a 'decent' level of clothing, food, housing, and medical care to rock-music, sexual orgasms, and meaningful relationships". The advocates of such rights ignore the fact that they conflict with other rights. Moreover, the right to decent housing, etc., "implies an obligation on the part of other people to provide it". In Block's (1981, p. 301) view, such rights amount to "a disguised, and therefore quite insidious, demand for wealth".

These new positive rights create a number of logical and moral problems in Block's view. First, there may not be sufficient wealth in the aggregate to satisfy them. Second, they presumably know no boundaries, hence so long as someone, somewhere is poorly housed we have a moral obligation to help alleviate this person's distress. Third, by their very nature negative rights (e.g., the right not to have one's property taken by another without due process of law) are egalitarian, therefore, if positive rights are interpreted in the same fashion, the claim expands from decent housing for all to one of equal housing for all. For these reasons, Block (1981, p. 302) asserts the claim of housing as a right must be rejected; it leads to "a moral swamp". Moreover, he points out that rent controls amount to a levy upon only one group -- landlords -- to finance an obligation of all members of society. The Community Review and Research Group (1975, p. 22), in responding to the argument that rent controls discriminate against landlords, has argued that such discrimination is justified by "the need to protect the public in a necessity of life that consumes the largest single portion of their income". Moreover, such differential treatment can be found in other sectors such as food, energy, and transportation, they argued.

3.3 Measuring the Problem of Affordability

Even where a concept is clear and well defined, the measurement of the extent of a problem is usually difficult. These difficulties are compounded when the concept itself is the subject of controversy. As we shall see, the difficulty lies in finding measurable proxies for what seems to be understood intuitively.

How is the problem of affordability defined in measurable terms? In most cases, an affordability problem is said to exist when

$$R/Y > x$$

where R = monthly rent (price times quantity of homogenous rental housing services);

Y = monthly income; and

x = some fraction, usually .25.

It is not difficult to criticize this measure — see Marks (1984b). First, it should be obvious from the inequality that the ratio of rent to income can exceed the criterion (x) if the rent is "too high" or the monthly income is "too low". In other words, the affordability problem could be just as easily construed as one of inadequate income as one of excessive rent.

Miron and Cullingworth (1983, pp. 88-89) try to distinguish between "housing affordability" and "income deficiency" by arguing that "the problem is a housing one when those with normal incomes cannot afford normal houses, whereas it is an income one for those whose incomes are insufficient to obtain normal houses". As they acknowledge, however, the problem shifts to what is meant by "normal". Using the rent-to-income ratio of 25%, there is a housing problem, in their view, if it is not possible to obtain standard accommodation at this ratio, while it is an income problem if a household cannot afford 25% of its income for housing after meeting the cost of the other necessities of life.

But what are the necessities of life -- bare physical subsistence or some relative measure of consumption, recognizing what one's contemporaries are able to enjoy?[19]

Second, the value used for x is essentially arbitrary. The number most frequently cited (0.25) appears to be based on an old English adage of "one month's rent equals a week's pay" for working class families in urban areas.[20] Fallis (1984, p. 27) holds the view that "the concept and [25%] rule are a poor proxy for the underconsumption of other things", i.e., non-housing goods and services. The measure of affordability should vary with the level of income, the relative prices of housing and other things, and the stage of the household in its life cycle. Others also wish to modify the criterion to reflect differences in family size and the household's "permanent income" rather than current monthly income (see Marks, 1984b).

However, the first step according to Fallis (1984, p. 28) "should be to define what the social entitlements are on all commodities, including housing". This is the approach used by Stone (1983, p. 103), who argues that "since housing is a necessity, is costly, and its cost is inflexible, and generally represents the first claim on households' disposable income, after paying for their shelter many people simply cannot adequately meet their non-shelter needs." He calls this situation "shelter poverty".

Third, Miron and Cullingworth (1983, pp. 90-93) describe some of the difficulties with the concept of affordability -- independently of determining the appropriate rent-to-income ratio. These include the fact that house buyers and some renters frequently have expenditures on housing that are far above conventional rent-to-income ratios; the rising absolute standard of housing; the role of long-run (rather than annual) income in explaining housing consumption; and the apparent change in taste for privacy (which may actually increase the statistical measure of the affordability problem).

Fourth, implicit in any concept of affordability is the question of adequacy, i.e., it is usually assumed that if a household's rent-to-income is less than the criterion (i.e., x in our formula), it is able to purchase "adequate" housing in terms of quality. Despite the rise in physical standards, in part due to building codes and zoning regulations, this may not be the case. Moreover, as Miron and Cullingworth (1983, p. 95) point out, even where people can afford "adequate" housing, they choose to live in inadequate housing and consume other goods and services or to save a greater portion of their income.

Fifth, writers on the affordability of housing ignore the fact that the famous .25 ratio is applied to before-tax income and that the total tax burden has increased quite dramatically in recent years. For example, Pipes and Walker (1984, p. 54) estimate that total taxes as a percentage of the average family's income before all taxes in Canada increased from 22.1% in 1961 to 33.2% in 1983.[21] During the same period, expenditures for shelter, food and clothing for the average Canadian family fell as a fraction of total income before tax. The decline was most dramatic for food — from 16.6% in 1961 to 8.9% in 1983. For shelter it was from 12.9% in 1961 to 10.2% in 1981 then up to 10.7% in 1983.

These data make another very important point: for the average Canadian family, even in 1961, shelter was not the largest single category of expenditure in the household's budget. Shelter was well behind taxes. However, for families in the lowest quartile of the income distribution, rent would be the largest expenditure category.

3.4 How Extensive is the Affordability Problem?

How extensive is the affordability problem in Ontario, for example? Steele and Miron (1984, pp. 10, 98, 99), using a criterion that varies with family size (i.e., x = .40 for a 1 person household; .25 for a 3 person household and .20 for five or more persons) found that in 1982 there were:

- 128,000 of all renter households (excluding subsidized renters) with incomes below the poverty line (defined by Statistics Canada) in which the rent-to-income ratio exceeded the criterion (Table 2, p. 98); and
- 166,800 of all renter households (excluding subsidized renters) with incomes less than twice the poverty line in which the rent to income ratio exceeded the criterion (Table 3, p. 99).

It should be noted that 91,700 of the households that have an affordability problem and are below the poverty line lived in urban centres of 100,000 population or more (Steele & Miron, 1984, p. 98).

Three estimates of the extent of the affordability problem in Ontario are as follows:

- Statistics Canada's Household Income, Facilities and Equipment (HIFE) micro data file indicates that for 23% of Ontario households their rent in 1978 was more than 30% of their 1977 income.
- The 1981 Census data revealed that 28.8% of renter households in Ontario spent more than 30% of their 1980 income on rent.
- CMHC estimates of "core housing need", based on HIFE data for 1980, find that 17.8% of Ontario renter households cannot afford adequate rental accommodation without spending more than 30% of their income on rent.[22]

Hulchanski (1984, p. 6) points out some of the difficulties in measuring the size of the affordability problem -- which he confines solely to tenants[23] -- and concludes that "no matter what [income] cut-off point one chooses to use, the percentage of tenants experiencing problems is in the 15 to 30 percent range". Clayton (1984, p. 6) states that the ratio in various studies lies between 18 and 29 per cent.

Marks (1984b, p. 53) notes that measures which estimate the improvement in affordability attributable to controls (such as the Ontario Ministry of Municipal Affairs and Housing, 1982a, p. 10) "disregards the fact that, while rents might have been lower in the controlled sector, they might have been higher in the uncontrolled sector".

Have things improved since rent controls were imposed in Ontario in 1975? Steele and Miron (1984, p. 16) provide data showing that "the number of households with affordability problems declined substantially over the period 1976-82; this point applies to both family renters and elderly renters. In large urban centres, the numbers dropped by 33%...over this period [using an income cut-off of twice the poverty line]." Using a somewhat different measure, Miron and Cullingworth (1983, Table 7.10) found that the number with an affordability problem rose substantially between 1972 and 1976, but that the trend was reversed between 1976 and 1978.

For the United States, Stone measured the extent of the problem by adjusting the measure for both income level and household size after determining a minimum level of cost of providing adequacy of non-shelter items. He estimates that in 1980 in the U.S. 32% of all households were "shelter-poor" (Stone, 1983, p. 105). The ratio for homeowners was about 26% while that for renters was 43%.[24]

3.5 Effectiveness of Rent Control in Ameliorating the Affordability Problem

In his extensive study of rent control as a policy to deal with the affordability problem for the Ontario Commission of Inquiry into Residential Tenancies, Marks (1984b, pp. 104-105) draws the following conclusions:

> At present, there is no evidence that rent regulation can solve the affordability problem in the long run. This is partly due to our failure to have good measures of affordability and partly due to our lack of data on long-run effects. Limited evidence from the Ontario experience suggests that most of its benefits have gone to households that do not have affordability problems. In addition, while it is too early to tell, the alleviation of some households' affordability problems in the short run may mean more serious and perhaps more widespread affordability problems in the longer run if the supply of housing falls because investment in housing becomes less profitable. Moreover, unlike virtually all other

> affordability policies, most of the funding under current legislation is not broadly based among the taxpayers of the relevant community but is concentrated among the owners of rental housing in the controlled sector and, to a lesser extent, property taxpayers who may have to increase their contributions to offset reduced revenues from devalued rental housing. Thus, the distributional benefits and burdens of rent regulation relative to most housing policies are particularly troublesome.

Why does rent control make little contribution to ameliorating the affordability problem of low-income households in Ontario? We must begin by examining the details of the structure and implementation of the rent control regime in the province. Among the points Marks (1984b, Ch. III) makes about the Ontario system that seem most relevant to the impact of controls on affordability are the following:

- The present Ontario system does not explicitly take affordability into account in the determination of allowable increases in rent. It is not obvious that the designers of the policy believe it should be directed to reducing the incidence of affordability problems.
- It is difficult for tenants to know the controlled rent for a unit -- there is, for example, no rent registry. (This problem was addressed in the first phase of the Commission of Inquiry's work.)
- Poor and ill-informed tenants may be less able to benefit from the administrative process that deals with applications for rent increases above the statutory rate (presently 6% but to be reduced to 4%).
- To the extent that controls succeed in keeping rents below the market-clearing level in the controlled sector, they may have the effect of raising them in the exempt sector and thereby aggravate the problem of affordability of those families unable to get a controlled unit. See Fallis and Smith (1984).
- There is presently no penalty for simply charging too much rent. When this fact is combined with the absence of a rent registry, it is obvious that there are few constraints on landlords who wish to set rents above the legal level.

Marks (1984b, p. 54) presents data for a small sample of buildings indicating that in 1980 the rate of return on controlled buildings was higher than on uncontrolled ones.

We need to answer several questions in regard to the role of rent control in helping to solve the affordability problem:

(i) Who are the intended beneficiaries of the policy?

(ii) How efficiently does the policy serve the intended beneficiaries; i.e., of the total amount of income that is redistributed, how much reaches the intended beneficiaries?

(iii) How effective is the policy? For example, if the "affordability gap" among the intended beneficiaries is $200 per month per household, does the policy reduce this amount by $10/month or $100/month?

(v) Is the benefit delivered to the intended beneficiaries at the "least cost" given the available alternative policies?

With respect to question (ii), I note that the Ontario Ministry of Municipal Affairs and Housing (1982) estimated that "about one-third of the rent savings goes to problem households and this is equal to about one-fifth of the total cost of the program". The Ministry concludes that "a one-third target efficiency is not a good performance. Still worse is the performance in meeting the problems of those in greatest need".

Miron and Cullingworth (1983, p. 127) found that there were slightly fewer Ontario households with an affordability problem in 1978 than in 1976. Could the decline be attributable to the rent controls enacted in December 1975 retroactive to mid-1975? It is doubtful that this is the case because of sampling variability (the result was not statistically significant), there were changes in the definitions employed, other changes in the environment may have been responsible, and Miron and Cullingworth could not control for these. None of the measures of changes in affordability seek to include the non-controlled sector, nor do they measure the longer-run impact of controls on affordability.

Controls may be inefficient in alleviating the present affordability problem, at least in economic terms -- no one dscusses the "political efficiency" of controls[25] -- and they may create more serious affordability problems in the future. Temporary controls may become permanent and, depending how they are designed and administered, they may restrict the number of new rental units supplied in the future. They may also reduce the quality of existing units unless the control system provides adequate incentives for maintenance, repairs, and the replacement of capital items.

Marks (1984b, p. 64) concludes that "the scattered evidence on the effects of rent regulation are bought at reasonably high cost". A more complete survey by Stanbury and Vertinsky (1985, Ch. 6) supports this conclusion. There are, however, alternative policies that could do a better job of helping low-income families meet the cost of decent rental housing.[26]

Notes to Chapter 2

1. "The Liberal Party Proposal for Tenant Protection in Ontario", submitted to the Ontario Standing Committee on General Government (attached to a press release by the Leader of the Opposition, Dr. Stuart Smith, Toronto, June 7, 1978), p. 1.

2. The theory here is standard micro-economic theory which holds that prices and particularly profits are a strong signal to investors to expand output of the good or service that is in high demand. If the position of the demand curve is unchanged, then increased supply will cause the supply curve to shift down and to the right. As a result, the price (in this case the rent of comparable units) will fall below the level it increased to when demand increased.

3. See the following studies prepared for the Economic Council's Regulation Reference: Eger (1980), Dale-Johnson (1981), Hamilton (1981), McFadyen and Johnson (1981), Silver (1980), and Proudfoot (1980). Regarding the U.S., see Frieden (1982), Johnston (1982), and Seidel (1978).

4. Clayton Research (1984, p. 5) indicates that the median income in 1980 of all renter households in Ontario was $15,500 as compared with $22,600 for all households. There was virtually no difference in income between renter and all non-family households. Among family households who were renters, 4.8% had incomes in excess of $20,000 in 1980. Clayton Research (1984, p. 8) also indicated that in 1981 15.0% of the rental stock consisted of single detached houses, 9.4% consisted of semi-detached houses or duplexes and 26.8% consisted of apartments with four or fewer units. Such units are usually owned by individuals, not large corporations. It is not at all obvious that the income or net wealth of these landlords exceeds those of their tenants. Clayton Research (1984, p. 10) reports that 44% of all landlords are individuals or husband and wife pairs -- however, they owned only 12% of all rental units in Ontario in 1980. Even though corporate landlords own 76% of all rental units (avg. = 160), one cannot conclude that the owners (stockholders) of these corporations are necessarily wealthier or have a higher income than their tenants. See also Stanbury and Vertinsky (1985, Ch. 6).

4a. For a dramatically different picture of the economic position of the landlord in Ontario, see the testimony of Martin Jelinowicz, owner of 17 units in Waterloo, before the Ontario Commission of Inquiry into Residential Tenancies, November 24, 1984. He made a very telling point about the mistrust of landlords by tenants by suggesting an analogy between restaurant owners and their customers: "If I go to a restaurant for a meal, I don't fear the owner. I won't eat there if I do. I expect the owner to run a profitable business."

5. There are two issues here. The first has to do with the impact on the tenant in present value terms. The figures here assume that the tenant's discount rate is the same as the compound rate of increase in rents. The second issue relates to the tenant's ability to predict the size and timing of increases and of arranging his finances to match the changes in his rent.

6. An important part of the "made-in-Canada" price of oil (and natural gas), embodied in the NEP, was a gradual move toward world prices over several years during which the Province of Alberta and the federal government (their taxpayers) helped to bear the cost of adjustment.

7. However, Di Canio (1982, p. 304) notes that "throughout American history, groups and individuals have sought political redress of nonexistent or overdrawn economic 'grievances', and advocacy of redistributive schemes need not be provoked by an actual decline in economic position".

8. Hayek views market processes as the most desirable means of coordinating the complex behaviour of millions of decentralized economic agents (individuals, firms) for the purpose of allocating resources. The basis of Hayek's "spontaneous order" is exactly the same as Adam Smith's "invisible hand", i.e., self-interest. Hayek values markets for two reasons. First, and most importantly, they are a way of providing individuals with the greatest degree of individual freedom while living in organized society. Second, markets are able to allocate resources more efficiently than other institutional processes.

9. Bucknall (1976, p. 2) explains the rationale for rent controls during wartime as follows: "A wartime economy generates new jobs and thus inflates wages and expands the ranks of wage earners. This new buying power cannot, however, be given full rein where the nation's resources and manufacturing systems are devoted to the war effort. The constricted supply can never meet the heightened demand and resulting inflation in prices must be curbed. The same analysis justifies the wartime rationing of consumer goods."

10. See also note 4 above.

11. For some attractive rental buildings in the controlled sector in Toronto there is a five-year waiting list of persons wishing to be tenants. The overall vacancy rate in the controlled sector is far below that in the uncontrolled sector. See data in Marks (1984b).

12. See Thom (1984).

13. This statement can be found in an 8-page brochure distributed by the Commission dated January 1983, p. 1.

14. Stanbury and Thain (1985, Table 5-3) report that the vacancy rate, as measured by CMHC, for 1-bedroom apartments in Toronto was 1.6% in December 1973, 1.0% in June 1974, December 1974 and April 1975, and was 1.6% in October 1975. Comparable figures for 2-bedroom units were 1.5, 0.8, 0.9, 1.0, and 1.7% respectively. Among Ontario cities, only Thunder Bay had lower vacancy rates in December 1974, April and October 1975. Toronto, however, was the locus of political agitation for rent controls in 1975. For more recent data, see Stanbury and Vertinsky (1985, Ch. 6).

15. See, for example, Averch and Johnson (1962).

16. It is important to appreciate that in the U.S. interest paid on a homeowner's mortgage is deductible in the computation of taxable personal income. This is a huge "tax expenditure". The short-lived Clark government

(1979-80) had promised to introduce amendments to the income tax legislation to permit the deductability of mortgage interest. Homeowners in Canada, in the view of Hulchanski (1984), for example, are receiving more favourable treatment than renters in terms of government policy.

17. This is a perfect illustration of the tendency of politicians to ennunciate goals in very general terms -- more as directions than as specific targets to be achieved within a certain time. Specific targets make it easy for critics to make invidious comparisons of performance and promise.

18. In Chapter 6 we discuss the particular sensitivity of increases in rent as an economic variable. See section 4.2 in that chapter.

19. For more discussion whether poverty can be defined in absolute or relative terms, see Stanbury (1985, Ch. 3).

20. Marks (1984b, p. 9) quotes Feins and Lane (1981) as follows:

> The rule of thumb about family expenditures for shelter was rooted in the common wisdom and experience of the nineteenth century. By the end of the 1930s, it has become well established as a way to describe actual family housing expenses and as a standard for maximum proportion of income that should be devoted to mortgage payments. Many people recognized that the rule was not an accurate statement of all household budgets, but nevertheless they found it a convenient way to simplify a complex issue. With the passing years, use of the rule spread in the housing field; debate about its suitability continued but no resolution was reached.

He notes that Lane (1977) indicates the 25% figure first arose in certain mill towns out of the practice of charging workers one week's pay as the monthly rent for company-supplied housing.

21. Except for families in the lowest decile, the ratio of taxes to total income increased for families at all income levels.

22. Miron and Cullingworth (1983, pp. 95-97) outline the "affordability gap" approach used in Great Britain to determine rent rebates and by CMHC's Task Force on Shelter and Incomes. It begins with an estimate, varied by household size, of the income necessary to obtain an adequate amount of non-housing goods and services. The housing affordability gap is the difference between the income remaining to purchase housing services and the market rent for adequate accommodation. Marks (1984b) discusses several different measures of affordabilty in some detail.

23. Few of those writing about the affordability problems faced by tenants acknowledge that homeowners or would-be homeowners can have an affordability problem. Presumably their difficulties are less poignant because, on average, the incomes of homeowners are well above those of tenants. Or it may be that where a middle-income family pays one-third or even one-half of its after-tax income on housing (PIT plus operating costs and taxes) it does so "voluntarily". See, for example, Goldberg (1983, p. 77). Presumably the phrase "house poor" refers to just this situation.

Goldberg (1983, Ch. 6) distinguishes between two types of affordability. Type I is analogous to the measures of affordability referred to above with respect to renters. For both renters and owners, he concludes that "at least one out of every seven Canadian households is experiencing difficulty in affording adequate housing". He continues and makes a telling point, "but these households also experience affordability problems with respect to the other necessities of life" (Goldberg, 1983, p. 81).

Affordability type II refers to the ability of households to purchase a home. As Goldberg points out, 63% of Canadian households in 1981 owned a home -- a slight increase over the ratio a decade earlier. He observes, "house prices rise only because people are willing and able to purchase houses" (p. 84). Goldberg (1983, p. 85) indicates that between 1971 and 1981 the price of new CMHC houses rose by 187%, the MLS Canadian average house price increased by 194%, but average household incomes rose by 226% and income per capita increased by 228%. During the same period, the CMHC rent index rose by only 55%!

What about the position of younger people? Can they afford what their parents have? Goldberg (1983, p. 85) indicates the average age of buyers of new NHA homes fell from 33.1 years in 1971 to 31.7 years in 1981 -- only in 1979 and 1980 did the average age rise from the previous year. In addition, the proportion of household income going to service NHA mortgages "has remained essentially unchanged since 1979, according to data available from CMHC" (Goldberg, 1983, p. 85). He concludes that "all of this hardly supports the case that there is any real affordability type II problem evident in Canada".

In the past few years housing prices in many Canadian cities were subject to a speculative boom -- followed by a substantial drop in prices. Rising unemployment and historically high interest rates took their toll. While there is no complete data series on mortgage defaults, assignments, or "walk aways" in Canada, the data on NHA mortgage defaults in Ontario point to the problem experienced by some homeowners -- see Table 2-5. The number of defaults increased from 102 in 1976 to 8002 in 1979 and was 2647 in 1983.

24. Stone (1983, pp. 115-125) offers what amounts to a neo-Marxist explanation of the roots of the housing affordability problem. It is based on "an inherent conflict or contradiction between two of the most basic institutions in capitalist society -- the labor market and the housing market" (p. 116).

25. The use of quotation marks is meant to raise the question of the calculus of instrument choice -- see Trebilcock et al. (1982). Governments have to make two fundamental choices in this context. First, whether to intervene at all; and second, if they are going to intervene, what governing instrument they should use. Given the decision to intervene, policies which are economically efficient may not be "politically efficient" in the sense of increasing the likelihood that the party in power will be re-elected. The "trouble" with the more economically efficient policies is that they often involve direct cash transfers or subsidies rather than policies which interfere with the working of market processes. The former are much more visible and therefore likely to be politically contentious. The latter may have much higher costs to society, but these costs are usually both diffused and hidden, and therefore less contentious.

26. Marks (1984b, Ch. IV) reviews the following alternative policies to ameliorate the affordability problem: guaranteed income, housing allowances, public housing, construction subsidies, and rent regulation targeted on those with an affordability problem, plus a cash subsidy to the tenant.

Table 2-5

Number of Units Defaulted Against CMHC Mortgage Insurance Funds, Ontario, 1973-183

Year	Total**	AHOP ARP GPM only	Col 2÷1	Default as % of Total Approvals	Interest Rate on Conventional 5-year Mortgages
1975	15	1	6.7%	.01%	11.43%
1976	102	12	11.8	.07	11.78
1977	589	150	25.5	.3	10.36
1978	3774	1373	36.4	2.8	10.59
1979	8002	3452	43.1	7.1	11.98
1980	6989	2434	34.8	6.8	14.32
1981	5531	2434*	44.0	7.0	18.15
1982	3413	1598	46.8	4.0	17.90
1983	2647	766	28.9	1.5	11.8-13.4

* appears to be an error in the original source, as the figures for 1980 and 1981 are the same.

** includes new and existing homeowners and regular rental as well as AHOP, ARP, GPM mortgages

Sources: Canada Mortgage and Housing Corporation (Toronto office); and Department of Finance (1983).

Chapter 3

RENT REGULATION TO CREATE RIGHTS: SECURITY OF TENURE

1.0 INTRODUCTION

It is often argued that rent regulation is desirable, all other things being equal, because it provides or increases the tenant's security of tenure. But security of tenure may also be a concern of tenants independently of rent control. As I shall point out, it can be difficult to disentangle the issues of rent control and security of tenure.

Security of tenure is seen by its advocates as a type of property right that should be embedded in legislation. It is seen as a basic form of protection against the unilateral actions of owners of rental property. Security of tenure, it should be noted, is a fairly broad concept. But the intuitive meaning is well expressed by the Federation of Metro Tenants Associations as follows:

> We feel the most basic right that can be given to tenants is that of security of tenure -- the right to freedom from arbitrary evictions, the right to the security of a home. As home prices and rents have soared, and vacancy rates shrunk, tenants have become, more than ever, at the mercy of their landlord and are more and more fearful of eviction. As long as landlords have the power of eviction without justification, tenants are unable to exercise their existing rights in fear of eviction, and any new rights tenants may be granted are meaningless.[1]

The Community Review and Research Group (1975, p. 2) of Toronto has argued that the right of all Canadians to good quality housing at affordable prices also includes "the right of tenants to enjoy full possession of their homes (and stability in their domestic lives) for as long as they see fit." Later in the report it is made clear that eviction should only be for "just cause" where the "causes for eviction or non-renewal of leases should be clearly defined and applicable to all rental accommodation..." (p. 15). However, it is argued that security of tenure also requires rent control to ensure increases are "reasonable or modest".

When tenancy is no longer a way-station on the road to home ownership, the terms and conditions of tenancy take on a greater importance. Security of tenure can be seen in "life or death" terms when one's home and hearth are threatened by economic or non-economic considerations. The New Democratic Party in Ontario put the matter as follows:

> A social right to housing means accepting the legitimacy of tenancy as a way of living: security of tenure; the right of enjoyment of rented premises; and some form of rent control. Without some form of rent control, landlords can evict by raising rents beyond tenants' ability to pay thereby making a mockery of security of tenure. And tenancy without security of tenure is pre-medieval.[2]

Hulchanski (1984, p. 76), while acknowledging that security of tenure provisions are necessary to "prohibit circumvention of rent review", argues that "rent review...helps prevent the circumvention of security of tenure provision. They go hand in hand." For some of the advocates of rent control, the rationale for security of tenure essentially boils down to a societal definition of what is fair and unfair in the landlord/tenant relationship. Jaffray et al. (1975, p. 33) state that one of the benefits of rent control is that it gives "real meaning to the concept of tenants having security of tenure". With better security "tenants will obtain the very real social benefit of peace of mind" knowing they will be protected from "large, extraordinary increases" in rent. They will not be the victims of rent "gouging".

If the purpose of rent control is, as stated by the Ontario Law Reform Commission (1968), "to make it possible for tenants to find and keep decent apartments at reasonable rents", then the concept of security of tenure appears to require rent controls to prevent people from being displaced by rising rents. In Hulchanski's (1984, p. 76) words, "a model tenant against whom no complaint is likely to be made can be dislodged by a rent increase more easily than an undesirable tenant can be evicted for cause". He sees security of tenure as taking two forms: "regulations governing the conditions of tenancy, especially the reasons for and the manner by which tenants may be evicted; and protection from economic eviction" (p. 77).

2.0 DIFFERENT CONCEPTS OF SECURITY OF TENURE

"Security of tenure" is a phrase that appears to have a variety of meanings. First, its meaning depends on the context in which it is used. Some tenant groups appreciate the fact that the 1970 amendments to the Ontario *Landlord and Tenant Act* provided tenants with new rights regarding security of tenure and imposed new constraints on the property rights of landlords. (See section 5.0 below.) However, it is argued that to make security of tenure "truly effective" it is necessary to impose rent controls to prevent "economic eviction".

On the other hand, some tenants favouring rent controls in the face of sharp rises in rents in 1974 and 1975 may have been less aware of the 1970 amendments and saw security of tenure as a necessary complement to rent controls to avoid what we might call "non-economic eviction".

It now becomes necessary to distinguish between economic and non-economic eviction. *Economic eviction* may be said to occur under the following circumstances:

(i) The landlord raises the rent of all tenants by the same percentage across the board. He does so in response to excess demand conditions. His purpose is to increase his total revenues, but he is assumed to be indifferent whether the existing tenants stay or go as he can replace them easily. The landlord is not trying to get rid of anyone, just increasing his net income. The rents are being raised to the new, higher market-clearing level.

(ii) The landlord intends to evict all tenants by raising rents very sharply. His object is to obtain a vacant building so he can undertake major renovations or tear it down and build a new building which may or may not provide rental accommodation. Again, his objective is assumed to be wealth maximization. The landlord uses this method of eviction because it is less costly than obtaining an eviction order.

(iii) The landlord intends to evict a particular tenant by sharply increasing his rent. The motivation for the landlord to do this may be, for example, that the tenant is noisy, has done damage, or has abused the landlord personally. The landlord resorts to economic eviction because it is "easier" than other forms of legal redress. The discriminatory action could also violate human rights legislation if it is based on the tenant's sex, religion, colour, or ethnic background.

Non-economic eviction can be defined as the landlord's unilateral termination of a tenancy without altering the rent. The motivations for this action could be many and varied. The landlord may be prejudiced on the basis of religion, colour, or ethnic background. He may have had trouble with the tenant in terms of collecting the rent, noise, or damage to the unit. The landlord may wish to rent the unit to a friend, even though the present occupant has been a model tenant. When rent controls are in place, landlords usually have a strong incentive to increase their net income by "upgrading the quality" of their tenants, i.e., by replacing problem tenants with those who are willing to abide by all the terms of the lease and would not require the landlord to resort to expensive forms of redress.

With very few exceptions, security of tenure provisions do not absolve the tenant from paying the (legal) rent. See section 7 below. In some cases, the rent may be paid into court where the tenant alleges the landlord has failed to undertake certain repairs or to maintain the building properly. Therefore, statutory protections in the name of security of tenure may still not be able to address the following problem. There is excess demand in the rental housing market and the average level of rents is rising. While rent controls may be able to limit such increases in the name of preventing "gouging", even the controlled rent may become beyond the means of some low- or fixed-income households. Is this a case of economic eviction? Should the law protect such tenants? As we shall see in section 9, a majority of tenants thinks it should not.

Legislation has been used to address certain problems, although its effectiveness in doing so is not known. For example, the landlord may not use rent increases to discriminate against particular individuals on the basis of colour, creed, or ethnic origin. Second, the landlord may not practice economic discrimination within his stock of units. That is, the landlord might like to charge different rents for essentially similar units, not to evict particular individuals, but to increase his income. He tries to act as a "perfectly discriminating monopolist" by getting the maximum rent each tenant (or potential tenant) is willing to pay. Rent controls which limit increases to a maximum percentage on each unit (versus building), when applied to a discriminatory rent structure, will obviously perpetuate the problem. Note, however, that what appears as discrimination may simply reflect differences in the costs of serving different tenants. Long term "good" tenants may pay less for the same unit than others do because the others may not pay their rent on time and may demand extra services. Note also that in a reasonably competitive market, the landlord's capability of gaining from the practice of economic discrimination is limited, i.e., he will have little or no market power.

It may be useful to distinguish two sets of circumstances to help clarify the security of tenure situation. In situation A there could be a limited form of security of tenure legislation such as that embodied in the amendments to the

Ontario Landlord and Tenant Act in 1970 (see section 5 below). Assume further there is no excess demand for rental housing and no system of rent controls. In this situation, both personal and economic discrimination could exist as we have described them above. However, the higher the vacancy rate, the less likely a landlord would be able to practice economic discrimination. The higher the vacancy rate, the more costly it would be for a landlord to practice personal discrimination because he would increase the likelihood of having vacancies. In other words, he would have to pay for his prejudices. Becker (1958), for example, has shown that in competitive markets racial discrimination makes both parties economically worse off.

In situation B assume security of tenure provisions exist as in situation A. Assume further, however, that a period of excess demand for rental housing prevails. Then, in the absence of rent controls, the "rising tide" of rent increases could "evict" lower income tenants because of their inability to pay. Should some form of rent controls be imposed to provide security of tenure? This question immediately raises several others. First, do we want to distinguish between rising rents that reflect real cost increases (heating fuel, taxes, interest rates, maintenance costs) and those that are purely demand-based and that therefore enable landlords of existing buildings to earn excess profits?

Second, do we want to give low-income tenants security of tenure in the face of a "rising tide" of rent increases only if they continue to pay a specified percentage of their income for rent even though the amount of rent is below the market rent? Third, if rent controls are imposed, and some poorer tenants still can't meet the legal rent increases, should they still be able to hold onto their units and pay the old rent or some maximum percentage of their income as rent? Fourth, if, in order to provide security of tenure to some tenants, a landlord's economic position is eroded, has the government not effectively taken part of his property for public purposes without compensation?

3.0 ARGUMENTS FOR SECURITY OF TENURE

Honore (1982, pp. 35-37) offers three arguments for security of tenure which are divorced from traditional concepts of property rights (as discussed in Makuch and Weinrib (1984, pp. 9-11)). They are based on what might be considered the reasonable expectations of tenants. The first is that of the pure economic interest of the tenant in the face of an abnormal situation in which rents could increase a great deal. Rent controls per se would be insufficient to protect the tenant. Low income tenants would not be able to pay the controlled rent let alone the market rent.

This argument is addressed by Hayek in his critique of widely held notions of "social justice". Hayek (1976, p. 93) suggests that the interference with the free functioning of markets is greatest -- in the name of social justice -- when it is "based on the idea that people are to be protected against an unmerited descent from the material position to which they have become accustomed". It is also widely deemed to be unjust to disappoint the legitimate expectations of wealth, particularly when they are based on socially approved forms of effort (input). The problem is made more acute when the change in circumstances is exogenous and could not have been foreseen. While generally less strong, there is frequently resentment against windfall gains. Hayek (1976, p. 94) is obviously unsympathetic to such arguments for he states: "our only moral title to what the market gives us we have earned by submitting to those rules which make the formation of the market order possible". The protection of established economic positions often amounts to the protection of politically effective interests. It becomes a social problem "when sufficiently large numbers clamour for protection of their accustomed position" -- often in the name of social justice (Hayek, 1976, p. 96).

The argument that rent controls are needed to prevent rent "gouging" or "unconscionable" increases in rents during periods of excess demand has been discussed in Chapter 2.

Second, Honore (1982) argues security of tenure can be based on the idea of preventing economic eviction of tenants who are *chronically* uncompetitive in rental markets that are efficient and not subject to important market failures. Hence, security of tenure is an adjunct to subsidies or income supplements to help those unable to acquire adequate housing. This argument is closely related to the affordability rationale discussed in the previous chapter.

Third, there is the psychological argument for security of tenure. As Makuch and Weinrib (1984, pp. 10-11) put it, "many tenants...become attached to their home even if it is rented from someone else. They do not want to move into economically equivalent housing even it if is provided." The British Columbia Law Reform Commission (1973) offered the following argument for greater security of tenure for tenants:

> While the landlord's interest in rented premises will generally be a purely economic one, a tenant will usually regard the premises as a home, and he may have a special attachment to the premises. Many commentators have noted that a secure home is a fundamental need of all families and all individuals; and where termination of a tenancy can take place within a short period of time, and justification is not required, this need is not fulfilled. Lack of tenant security may also have severe practical consequences. For example, the need for a secure home is accentuated where school-age children are involved. The situation may also be serious in practical terms where the tenancy of an elderly person is terminated. The cost of upheaval to the tenant, both economically and psychologically, may be substantial. (quoted in Miron & Cullingworth, 1983, p. 42)

In the same vein, a New Jersey judge argued as follows: "The home, whether rented or owned, is the very heart of privacy in modern America. Man's place of retreat for quiet and solace is the home. Whether rented or owned, it is his sanctuary. Being uprooted and put into the street or moving from place to place is a traumatic experience." Moreover, he argued that "every human being has a right to be housed. And to some degree he has a continuing right not to be uprooted annually. At least, such a person should have some area for participation in this annual procedure of rent revisions."[3] Therefore, he concluded, security of tenure -- the right not to be unreasonably uprooted -- requires some form of rent regulation. We discuss later in this section how demands for greater security of tenure have been used to obtain local rent controls.

Davidoff (1983, p. 195) argues that housing's locational value may be almost as important as its shelter function "because of its relationship to job opportunities, transportation, environment, education, and other goods". Of particular concern is the "socially destructive effects of residential displacement of lower-income and minority households resulting from the increasing pace of revitalization of city neighborhoods" (p. 196). Davidoff (1983, p. 199) asserts that "stability of place is important for purposes of achieving economic and social mobility". However, the right to remain in place is conditional on paying the rent and not damaging the premises. The object is to prevent involuntary removal for "arbitrary or discriminatory reasons". However, the desire of the landlord to earn a higher return would not be justifiable if he was earning a "reasonable return".

The psychological aspects of housing are obviously important. Dwellings are places in which important events occur. They are the focus of family life. Rental premises are homes, not merely "dwelling units" as described in cold statistics. The very word "home" is evocative. We are told that is where the heart is.

There are other psychological dimensions involved in housing. For example, Atlas and Dreier (1983, p. 160) suggest that

> ...to most people housing is a private matter, a refuge for the individual and family from the ravages of the work world. The workplace is a source of drudgery or competition, a continual test of one's worth and self-esteem. Physically as well as psychologically, one returns home to relax, to retreat, to get away from the pressures of work.

A home is a where one's children are conceived, where they grow up, and where the neighbours are welcome to drop in for a cup of coffee and a chat. A home is a place filled with memories both good and bad.

A home is also a reflection of our personality, a signature of our identity. How else can we explain the time, money and energy we spend on its decoration and furnishing -- after we have found the right dwelling?

Emotionally, the investment in a home -- rented or owned -- is often far greater than the monetary expenditure it represents. Financial investments may become sunk costs, but the emotional commitments to a home remain fresh in the mind and grow with the accumulation of memories.

It should be apparent, therefore, that actions that are perceived as threats to the continued security of possession of one's home could evoke a strong response not only from the persons directly involved, but also from other members of the community who empathize with them.

Knetsch et al. (1984, p. 6) argue that "in the case of the accommodation an individual presently occupies, there may be an even greater preference for that premises over others. As the current occupants have previously chosen their particular rental unit from among all that were available, they presumably made their choice on the basis of some special attraction." Moreover, as time passes, "the particular attachment and value placed on the current holding may have grown as they become familiar with the accommodation and the neighbourhood, and made friends nearbly. As a result, sitting tenants will experience a significant loss even if all cash costs of moving are covered and apparently similar accommodation can be obtained at the same rent. There will be an asymmetry between what a tenant would be willing to pay to obtain a particular rental unit and the amount needed to compensate him for giving up the particular accommodation he now occupies." Knetsch et al. (1984) refer to some empirical evidence to show individuals' reluctance to trade and the fact that the disutility of real losses (but not opportunity losses) are far greater than the utility of gains. Second, assessments of the value of losses based on people's willingness to pay are very likely to underestimate the losses. They conclude that "an involuntary change is therefore likely to affect an individual's well being more adversely and more severely than would be suggested by what people pay to prevent such changes" (Knetsch et al., 1984, p. 9).

Researchers for the Commission of Inquiry into Residential Tenancies conducted a randomly selected telephone survey of 683 renters in the Toronto area in 1984 as part of a survey designed primarily to assess non-pecuniary values and the importance of fairness considerations (Knetsch et al., 1984). Among the questions asked was the following: Assuming that your moving costs are covered, would you agree to move if you were paid $ X ? The sample was divided into eight parts using four different amounts for $X and whether or not comparable rental housing was available in the neighbourhood. The results are reported in Table 3-1. These figures should be compared to the tenant's average monthly rent of $443.

Table 3-1

Proportion of Renters Who Would Refuse To Move From Their Present Accommodation if Offered Compensation Over and Above Their Moving Costs

	Amount of Compensation				
Assuming	$1000	$3000	$5000	$7000	$10,000
Comparable rental housing is available in the neighbourhood	42% n=69	50% n=65	32% n=56	24% n=66	18% n=66
Comparable rental housing is not available in the neighbourhood	56% n=77	47% n=74	40% n=73	34% n=77	20% n=70

Source: Knetsch et al. (1984, Table 1, p. 12).

As expected, the proportion of renters refusing to move decreases with the level of compensation. But even when comparable rental housing is available in the neighbourhood (and moving costs are paid), almost one-fifth of the sample would refuse to move if offered $10,000 compensation. Also as expected, the proportion refusing to move at various levels of compensation is greater (with one exception) when comparable housing is not available than when it is.

Knetsch et al. (1984, Table 2) found the refusal rate increased with the length of time the tenant had lived in his current accommodation. For example, for all four offers, where accommodation was available and the tenants had been there less than two years the refusal rate was 25%, while it was 36% for those living in the same unit for more than five years. The comparable figures where no comparable accommodation was available in the same neighbourhood were 28% and 58% respectively.

For the entire sample Knetsch et al. (1984, p. 14) found, "surprisingly, [that] tests revealed that there was no consistent, statistically significant relationship between the amount of rent being paid and their willingness to accept the various amounts of compensation for moving. There was also no clear relationship to household income (as reported by the respondents)."

4.0 SECURITY OF TENURE INDEPENDENTLY OF RENT CONTROL

Some degree of security of tenure can be effectively obtained independently of rent control. The Province of Ontario provides evidence for this point. Amendments to the Landlord and Tenant Act in 1970 — five years before rent review was introduced -- greatly shifted the balance of rights and obligations in favour of tenants and away from landlords (Makuch and Weinrib, 1984; Gorsky, 1976-77).[4] Klippert (1976, p. 2) states that the philosophy behind the amendments -- "the first progressive piece of legislation affecting residential tenancies in Canada" -- was that the "legislature must intervene to obviate the 'mechanical' aspects of the common law and substitute in its place, a 'realistic' standard of vital interests which the law will endeavour to protect".

The amendments moved rental arrangements from the feudal concept of an "estate in land" to a more familiar concept of contract. In particular, the modern notion of contract law based on principles of reasonable reliance and reasonable expectations was incorporated into the Act. Certain conditions of the contract were made statutory and non-waivable by tenants. Specific duties were created for landlords. Most importantly, the amendments created the legal framework for security of tenure for tenants.

While describing the 1970 amendments as a "huge step forward by bringing the law respecting tenancies out of the 16th century", the Federation of Metro Tenant's Associations states that two years later the Act was amended "as a result of pressure from landlords". They have argued that

> The effect of these amendments was to change the section dealing with termination of tenancies to shorten the time required for eviction procedures or recovery of arrears of rent and make it more difficult for tenants to defend themselves against such procedures. It also removed the tenant's right under section 106 to bring summary application for termination of tenancy.[5]

The central idea of security of tenure lies in the set of conditions under which a tenant may continue to occupy rental premises. Before recent statutory intervention,

> "both the landlord and the tenant had the unfettered common law right to unilaterally terminate their periodic tenancy upon giving notice in the proper form. If the notice to terminate was in the proper form and the termination did not contravene some express covenant or condition contained in the tenancy agreement, the tenant was not entitled to defeat the landlord's action for possession on the basis no good or sufficient reasons had been given for the termination" (Klippert, 1976, p. 41).

The idea that security of tenure lies in the set of conditions under which tenants may continue to live in their present dwelling is acknowledged by the Federation of Metro Tenant's Associations.

> Tenants should be allowed to remain in their premises for as long as they may want, except in the following four cases -- malicious damage to premises, persistent non-payment of rent (except in the case of rent strikes), persistent and undue nuisance which seriously affects the reasonable enjoyment of other tenants, or where the landlord requires the accommodation for his own personal use as his primary residence. In the first three cases, landlords would be allowed to apply for termination either during or at the end of the tenancy agreement. We feel that in the first and third cases, the problem must be extremely serious before termination is allowed to be granted during a tenancy agreement. In the fourth case, termination should only be allowed at the end of the tenancy agreement. Also, every tenant should have the right to a lease if he desires one.[6]

Today, both attitudes and the law have changed. Elaborate rules have been promulgated regarding the rights of tenants to continue in possession of rented accommodation and even stronger provisions are being recommended. The result, in Klippert's (1976, p. 42) view, is that a landlord in British Columbia, for example, may find it easier to divorce his wife than to evict a tenant if the recommendations of the Law Reform Commission of Canada are adopted.

Security of tenure independent of rent control usually involves the following elements:[7]

- The right to occupation of a dwelling so long as the rent is paid in accordance with contract (lease) between landlord and tenant;
- The prevention of discrimination in the form of differential rent increases by a landlord for essentially the same type of accommodation; and
- Provisions concerning the duration of security of tenure. Do the tenure rights apply only to the tenant in occupation or to his heirs and assigns? It is usually assumed that such rights apply only to the tenant in occupation but it need not as other jurisdictions make clear, e.g. New York, Hong Kong, United Kingdom, British Columbia (Makuch & Weinrib, 1984, pp. 20-22).

Such security of tenure, however, is conditional. It is usually limited by the following conditions:[8]

- the conduct of the tenant, i.e., he is entitled to the quiet use and enjoyment of the premises and must act consistently with the safety of others;
- reimbursement for damages to the landlord's property beyond normal wear and tear;
- misrepresentation by the tenant to a potential buyer of the property;
- the use of the premises by children;
- the landlord's need for possession for use by himself or his immediate family; or
- the landlord's need for possession for the purposes of redevelopment, e.g., conversion to condominiums, demolition and rebuilding etc. (Makuch & Weinrib, 1984, pp. 23-30).

Security of tenure involves balancing the rights and duties of both landlords and tenants. But where should the balance lie? These issues are discussed in section 8. I now discuss the details of the 1970 amendments to the Ontario Landlord and Tenant Act.

5.0 THE 1970 AMENDMENTS TO THE LANDLORD AND TENANT ACT

Following the Ontario Law Reform Commission's Interim Report on Landlord and Tenant Law Applicable to Residential Tenancies in 1968, the government of Ontario enacted a major set of amendments to the province's Landlord and Tenant Act which came into effect on January 1, 1970. Not all the changes related directly to the security of tenure issue, but they had the effect of altering by statute the nature of the legal relationship between landlords and tenants. As we have noted, what were almost feudal doctrines gave way to the more general law of contract. I have grouped the important changes into four categories.

5.1 Statutory Provisions Concerning the Tenancy Agreement

- The landlord was required to provide a copy of the lease, if the tenancy agreement is in writing, to the tenant within 21 days of its execution (S.83).

- The tenant was given the right to assign or sublet but the tenancy agreement may provide he could do so subject to the consent of the landlord, but such consent "shall not be arbitrarily or unreasonably withheld" (S.91).

- Either a landlord or a tenant could apply to a judge of the county or district court to resolve disputes concerning a tenant's assignment or subletting of his lease (S.91(5)).

- The landlord was required to give written notice 24 hours before he enters the rented premises -- except where the tenant consents or in cases of emergency or during reasonable hours after a tenant has given notice in order to show the premises to prospective tenants (S.93).

- Landlords could not restrict federal, provincial or local election candidates from reasonable access for the purpose of canvassing or distributing election material (S.94).

- The landlord or tenant could not change the locks giving entry to the rented premises except by mutual consent (S.95).

- The landlord was responsible for providing and maintaining the rented premises in a "good state of repair and fit for habitation...and for complying with health and safety standards..." (S.96(1)).

- "The tenant is responsible for ordinary cleanliness of the rented premises and for the repair of damage caused by his wilful or negligent conduct or that of persons who are permitted on the premises by him" (S.96(2)).

- Either the landlord or the tenant could enforce the provisions of S.96 by summary application to a judge of the country or district court (S.96(3)).

- If a tenant was in default on the rent and thereby triggered an acceleration clause making the remaining rent for the tenancy due and payable, the tenant was relieved of the consequences of default if he paid the rent due (excluding the amount attributable to acceleration) and paid the landlord's expenses before any judgment was made (S.97).

5.2 Security Deposits

- Security deposits were limited to one month's rent, to be applied as the last month's rent under the tenancy agreement (S.84(1)).
- The landlord was required to pay 6% interest on security deposits (S.84(2)).
- The landlord was not permitted to require post-dated cheques for the rent (S.84(3)).
- The landlord could not retain any part of the security deposit unless he notified the tenant of his reasons for doing so and the tenant consented in writing, or the landlord obtained an order from a judge of a county or district court (S.85(4)).

5.3 Abolition of Old Doctrines

- The landlord's right of distress under the common law or in any statute was abolished. (S.86).
- The doctrine of interesse termini was abolished (S.87).
- The doctrine of frustration of contract as it applied to tenancy agreements was abolished (S.88).
- Where a tenant abandoned the premises in breach of the tenancy agreement, the landlord's right to damages was subject to the same obligation to mitigate his damages as applies generally under the rule of law relating to breaches of contract (S.92).

5.4 Termination of Tenancies

- Landlords and tenants were required to give the following periods to end a tenancy:

period of tenancy	period of notice
weekly	1 week
monthly	1 month
yearly	60 days

(S.101, S.102, S.103).

- For a landlord to be able to evict a tenant under a court order he had to provide notice of termination in writing containing certain particulars (S.99) Similarly, he must serve the notice in a particular manner (S.100, S.109).

- The landlord was required to post and maintain in a conspicuous place a copy of sections 98 to 103 and 109 regarding notice of termination. He also had to post his legal name and his address for service of documents by tenants (S.104).

- Either a landlord or a tenant could apply by a summary application to a judge of a county or district court for an order declaring the tenancy agreement is terminated, i.e., for a writ of possession in the case of the landlord. The application had to state the grounds for termination (S.106). Note: this provision was subsequently amended in 1972 to restrict applications for terminations to landlords.

- The landlord could not regain legal possession of the rented premises except where the tenant had vacated or abandoned them, or with the authority of a writ of possession obtained from a court (S.107).

- The landlord was entitled to compensation for the use and occupation of premises after the tenancy has been terminated by notice and his acceptance of arrears or compensation after notice has been given does not operate as waiver of the notice (S.105).

These amendments demonstrate that rules governing the landlord-tenant relationship, including security of tenure provisions, were a policy issue in Ontario prior to demands for rent controls in 1975.

6.0 SECURITY OF TENURE IN THE CONTEXT OF RENT CONTROL

We now address the issue of security of tenure in the context of controls on rent. Writing in 1945 and reflecting the wartime experience with rent controls in Canada, Mr. Justice Spence stated that "security of tenure is absolutely necessary for the enforcement of control of the price; experience has shown that as soon as security of tenure is let go, control of price disappears" (quoted in Makuch and Weinrib, 1984, pp. 30-31). It is argued by Makuch and Weinrib (1984, p. 32) that "security of tenure is coupled with rent control to meet the social welfare objective of affordable housing".

What is necessary in terms of security of tenure in order to make rent controls effective? First, tenants must be protected against "retaliatory eviction" because of complaints to regulatory authorities concerning the health, safety, or condition of the dwelling, or because of their efforts to exercise their rights under rent control legislation. In fact, the tenants may be less likely to obtain the benefits of their legal rights without sufficient security of tenure.

Second, non-economic eviction must be prevented except under well-specified conditions. In other words, landlords must not be able to use some minor non-rent issue to evict a tenant in order to let the premises at a higher rent because rents can be increased between tenants. (In Ontario the rent cannot legally be increased between tenants except where the tenant's departure coincides with the end of the rent year. However, where a new tenant is not aware of the legal rent for a unit, landlords may be able to raise the rent with impunity.) In some versions of rent control, the rent may be increased legally between tenants as part of the concept of "vacancy decontrol" -- see Stanbury and Vertinsky (1985).

Third, security of tenure provisions are needed to prevent circumvention of rent controls through conversion to condominiums, co-operatives, or to other non-controlled uses. Similarly, demolitions must be controlled or part of the controlled rental stock will disappear, although the total housing stock may increase if the new building has more, but uncontrolled, housing units. Fourth, landlords must be prevented from practising non-economic discrimination whereby they act to get "better quality" tenants, i.e., those who are less costly to serve because they always pay their rent, never damage the premises, and demand fewer amenities. It should be appreciated that such efforts by landlords, while distasteful to some, merely represent economically rational behaviour in light of the constraints imposed by rent controls.

Finally, Makuch and Weinrib (1984, p. 31) argue that one view of security of tenure is that it is an attempt to maintain affordable housing. They state that "if one believes that the purpose of rent control is to ensure the social welfare of tenants and the affordability of their housing it can be argued that tenants who cannot afford to pay their rent should not lose their security of tenure". In the same vein, they argue that "as long as a need is present among family members sharing premises, security of tenure should extend to those people as well".

If security of tenure goes this far, a scheme whereby landlords compulsorily subsidize all tenants to some degree becomes a scheme whereby they are forced to subsidize some tenants to the full extent of the rent. It should be obvious that "once security of tenure is tied with general rent control then its limits are difficult to maintain". There is the obvious problem of moral hazard. What do we do if a tenant chooses to quit work and live on social assistance and is thereby "unable" to pay the controlled rent? Is security of tenure to apply in this instance as well?

7.0 THE 1975 AMENDMENTS TO THE LANDLORD AND TENANT ACT

Eight days after the Government of Ontario introduced the legislation to enact rent regulation (Residential Premises Rent Review Act, first reading November 6, 1975), it introduced Bill 26, an extensive set of amendments to the Landlord and Tenant Act. The "explanatory notes" accompanying the bill described its features as follows: the extension of the provisions governing residential tenancies to mobile homes in mobile home parks; "the affording of security of tenure to tenants of residential premises"; the clarification of the rights of both landlords and tenants and the creation of expeditious procedures for remedies for breach of the provisions of the legislation; and the requirement that a landlord give at least 90 days' notice of any proposed rent increase. After considerable debate in committee and after a number of amendments put forward by the opposition parties were made, Bill 26 obtained third reading and royal assent in December 18, 1975. The provisions most directly affecting security of tenure consisted of about 10 pages of amendments to the sections dealing with the termination of tenancy agreements by landlords and the rules and criteria to be adopted by district or county courts in handling disputes over termination.

The important changes included the following: first, the notice of termination of all types of residential tenancies shall be in writing, and shall, inter alia, "specify the reasons and particulars respecting termination". At the same time, the landlord is required to inform the tenant he need not vacate pursuant to the notice of termination, but the landlord may apply to a court to gain a writ of possession, which the tenant may dispute (S.99).[9] Second, the periods of notice were lengthened as follows:

type of tenancy	period of notice
-weekly	28 days
-monthly	60
-yearly	60
-fixed term under one year	60
-fixed term of one year or more	60

(Sections 100-103a)

Third, a landlord could terminate a tenancy at the end of the tenancy agreement for the following reasons:

(i) Where the landlord bona fide requires possession for the purpose of occupation by himself, his spouse, or a child or parent of his or his spouse (S.103b). Here the minimum notice is 60 days in all cases.

(ii) Where the landlord requires possession for the purposes of demolition, conversion to a use other than rental residential premises, or repairs or renovations so extensive as to require a building permit and vacant possession (S.103d). Here the minimum notice is 120 days in all cases. In this case, where the reason is renovation, the tenant has a right of first refusal once the unit has been renovated. The notice of termination by the landlord is not valid unless the tenant vacates or unless the landlord applies for a writ under S.106 within 30 days of the proposed termination date. A judge shall not issue a writ unless he is satisfied the landlord has met the conditions "and has obtained all necessary permits or other authority required...". (This provision gives local governments an opportunity to constrain the landlord's ability to terminate per S.103d.)

(iii) Where the landlord has a *cause* for termination (and has sought an order under S.106 within 30 days of the proposed date of termination). The causes set out in S.103g include:

- those set out in sections 103e or 103f,
- the landlord requires possession for himself etc., and has complied with S. 103b;
- the tenant has *persistently failed* to pay the rent when due;
- the tenant has ceased to qualify for units that are part of an NHA non-profit, limited dividend project;
- the tenant was an employee of an employer who provided residential premises during his employment and his employment was terminated; or
- the tenancy arose in relation to a purchase or sale under the *Condominium Act* and that agreement of purchase and sale has been terminated.

Fourth, a landlord can terminate a tenancy *before* the end of the tenancy agreement for the following reasons:

(i) The tenant's failure to pay the rent in accordance with a tenancy agreement. However, the tenant can stay if he pays up within 14 days of the notice of termination, which must be 20 days before the proposed date of termination. Even if the tenant fails to pay up and the landlord applies to the court per S. 106, the tenant can stay if he pays the rent up to date and the landlord's costs before the judgment becomes final. See S.103e.

(ii) One of the six causes listed in S.103f, i.e.,

- damage by the tenant,
- illegal acts in the premises,
- conduct that substantially interferes with the reasonable enjoyment of the premises by the landlord or other tenants,
- serious impairment of the safety or other bona fide and lawful rights of other tenants,
- an excessive number of persons in the unit, or
- material misrepresentation of income in an NHA non-profit, limited dividend project.

Note in this case 20 days' notice is required, and the tenant has 7 days in which to comply, i.e., make repairs, reduce the number of persons in the unit, etc. However, if the tenant gives cause for eviction again within 6 months, only 14 days notice is required and the landlord is entitled to make an application under S.106. In any event, the landlord must apply per S.106 within 30 days of the proposed termination date.

Fifth, section 107 was amended to provide that a judge may refuse to grant a writ of possession "unless he is satisfied, having regard to all the circumstances that it would be unfair to do so". He may also postpone enforcement of the writ for up to one week. In addition, a judge shall refuse to grant an application for a writ where he is satisfied that:

- the landlord is in breach of his responsibilities under the Act or "any material covenant in the tenancy agreement"; or
- a reason for the application is that the tenant has (i) complained to a governmental authority regarding a health or safety standard, or (ii) attempted to secure or enforce his legal rights, or (iii) the tenant is a member of a tenants' organization or is trying to organize one; or
- a reason is that the premises are occupied by children (provided there is no over-crowding and the premises are suitable for children). This would appear to mean that tenancy agreements barring children cannot be enforced on that point.

Sixth, section 107 was amended to provide that a landlord shall not withhold a reasonable supply of any vital service such as heat, fuel, electricity, gas, or water that he is obliged to supply under a tenancy agreement -- until a writ of possession is executed. Similarly, the landlord shall not "substantially interfere with the reasonable enjoyment of the premises ... with intent to cause the tenant to give up possession or refrain from asserting his rights".

It should be apparent that these amendments dealt with two types of security of tenure provisions. Some are clearly designed as complements to rent controls to ensure that landlords cannot obviate the intent of the controls by some form of non-economic eviction, e.g., section 103d regarding conversion, renovation, or demolition. Whether they "go too far" when considered in conjunction with municipal by-laws is another question.

Some of the amendments are not necessary and incidental to rent controls, but amount to the implementation of a value judgment that the position of the tenant should be strengthened vis-a-vis that of the landlord. Consider sections 100-103a lengthening the period of notice of terminaton of the tenancy agreement. Or consider section 103e which allows a tenant to end legal proceedings against him for non-payment of the rent by paying all of the amount in arrears (and costs) any time before judgment is executed against him.

Regarding economic evictions, the 1975 amendments are significant for what they do not contain. They do not contain a section allowing a tenant to continue in occupation of a rented premises if he is unwilling or unable to pay the rent -- controlled or otherwise. Tenants may be evicted, per S.103g, for persistently failing to pay the rent when it is due and payable. There is no provision in the Ontario Landlord and Tenant Act that requires tenants with an income below a specified amount to pay only X% of new income as rent where a rent increase would raise their rent above some pre-determined ratio of rent to income.

8.0 SHIFTING THE BALANCE OF POWER: SECURITY OF TENURE AS A RIGHT

Unquestionably the traditional rights of private property have been sharply fettered by a host of legislative initiatives such as the ones described in the previous section.[10] The traditional rights of private property include the exclusive right to decide on the use of one's property, the exclusive right to receive income from the use of the property, and the right to transfer the property freely, subject to specific encumbrances (Cheung, 1974). Restrictions have been placed on these rights and on the parties' freedom of contract. Freedom of contract in the common law meant that parties to a tenancy agreement had broad powers to determine for themselves the obligations and rights arising out of their relationship. Klippert (1976, pp. 34-35) points out that the 1974 amendments to the British Columbia Landlord and Tenant Act went

> "far beyond the mere regulation of the form of a tenancy agreement, pre-empting the parties from contracting on the very substance of the landlord and tenant relationship, including the duty to repair, access to premises, setting and increasing of rent, and the basis of terminating the relationship. All that is left of freedom of contract is a limited type of obligation or restriction which has been given a circumscribed orbit around the main constellation of statutory covenants.

Should security of tenure be a right to be enjoyed equally by all tenants, or should it be more narrowly focused on those most in need of public protection? About whom are we most concerned? The strongest case for security of tenure (over and above the minimum rights available to all that might consist of the provisions in the amendments to the Ontario Landlord and Tenant Act in 1970) appears to be on behalf of the least mobile and most vulnerable members of the community. These would likely be the elderly, particularly those on modest, fixed incomes; and single mothers with school-age children -- again particularly those with low incomes. For both groups, the economic and psychological costs of moving are likely to be the greatest in relative terms.

As a matter of policy design it would be inefficient to cast the security of tenure net too broadly so as to include individuals who are not only better able to protect themselves, but also have different propensities toward risk. The effect of universal, stringent security of tenure provisions is to create a compulsory form of insurance for all tenants -- whether they like it or not. In effect, the premium to pay for security of tenure is bundled into the rent payment. A priori, it is not clear who pays this insurance premium, the landlord or the tenants. In the long run, it seems reasonable to believe that tenants bear the cost. But not all tenants value these security of tenure protections equally. Yet they cannot opt out and request a lower rent from their landlord. These tenants are helping to finance a social program they would prefer not to have.

The shift in the balance of rights and obligations (and balance of power), although it obviously reflects, as the law usually does, changes in social values, troubles some but not others. Hulchanski (1984, pp. 75-76), for example, argues that the amendments in Ontario "cannot be seen as taking away property rights from the landlord, because such a view assumes that there is some socially defined agreement on what property rights of the landlord are".

He sees such changes to property rights that give security of tenure to tenants as being in the same category as "socially defined reasonable regulations over zoning, land use planning, health and safety of the structure, demolition and conversion. They fall into the very broad category of consumer protection regulations, which govern other goods and services of many kinds."

Others see the matter quite differently. Pilon (1982), for example, contrasts the traditional view of property rights and individual freedom with the newer concepts of "people's rights" under whose banner tenants have obtained a legally more advantageous position. In his view, although "people's rights" are part of the demands for a freer society, their concern "is not with individual freedom but with so-called 'collective freedom'". Under such an approach, property rights are an impediment to, not a condition of freedom. "Private property is not to be secured but abolished -- or better, to be collectivized, thus ensuring freedom for all, the freedom of all to use that property" (Pilon, 1982, p. 373).

Sowell (1980, p. 123) states that "a property right is a differential privilege of some to exclude others from decisions or activities involving some physical or intangible object of value". He reminds us that "only human beings have rights" and that "property itself has no rights". It is argued that the right to own property, including oneself, is one of the most basic of all rights. The issue, therefore, is not property rights versus human rights but what the alternative decision-making mechanisms are by which we resolve conflicts involving trade-offs among alternative goods (Sowell, 1980, p. 388, n. 18). The definition of property rights creates self-interested monitors which have a vested interested in protecting the value of such rights. "Property rights are intended to secure gains to society at large, including numerous persons who own no significant property" (Sowell, 1980, p. 126).

The new approach to property rights, however, requires the taking of freedom, in the sense of power, from some in order to increase the freedom or power of all -- or at least of some identifiable group. As Pilon (1982, p. 377) points out, "in principle there is no end to this redistributing process...". Di Canio (1982, p. 313) makes an important point when he argues that any measuring involving large-scale redistribution does not appear on the political scene out of a vacuum. "Such measures can thrive politically only in an environment in which government-sanctioned redistributions of wealth and income are viewed as legitimate." At present, despite some constitutional constraints -- of which there are fewer in Canada -- "all of a person's or a corporation's wealth is 'up for grabs'" and "nowhere is the subjugation of property rights to the political process more evident than in the real estate market as a whole".

The justification of the new approach to property rights -- when indeed its advocates feel compelled to offer one -- is seen by some to be extremely simplistic. In the words of one critic, "At best we are told that 'need' or 'want' entails 'entitled to' ... the logical gap here is yawning" (Pilon, 1982, p. 379).

Why should the property rights of landlords be sharply restricted and the property rights of tenants be expanded and strengthened in the form of security of tenure? Hulchanski (1984, p. 77) sees the shift as a form of consumer protection "where the market cannot function normally, such as in meeting supply, or when moving costs limit the mobility of the consumer of rental services...". Hence, groups "in an inferior bargaining position, quite naturally turn to government for protective regulations".

In fact, Hulchanski mixes two lines of argument. The first is the existence of a true (technological) market failure which results in a less than Pareto-optimal equilibrium. The second, which upon further reading is his real concern, is the matter of income distribution when rents -- even in efficient markets -- are rising "too fast' so that, all other things being equal, the real income of tenants is falling or increasing more slowly than they had been accustomed to. This is, of course, a purely normative argument and Hulchanski does not feel it necessary to provide data to indicate if it has occurred -- although he does cite the work of Owen and Braeutigam (1978) on the uses of regulation to reduce the speed of economic change.

Fallis (1984, p. 29) argues that security of tenure and the right to private property are often two sides of the same coin. In his view, "absolute security of tenure ...means that a tenant would be protected against any fall in income or increase in the market rent that would cause him to leave the apartment and moreover, that the landlord could not, on any grounds, refuse to continue the rental" (p. 30). In other words, the tenant would have all of the rights of ownership and none of the responsibilities. In his view, this is not what society wants.

It is too strong, however, to say as Fallis (1984, p. 31) does, that "each restriction on the property rights of the landlord increases the security tenure of the tenant". It is a common feature of government intervention that the costs imposed on some groups are much larger than the benefits received by the targeted beneficiaries of a policy action. Therefore, creating a new right to security of tenure can be a negative-sum game, not merely a zero-sum game as Fallis suggests. We should not rule out the possibility that the creation of a new right such as security of tenure can also be a positive-sum game. For example, it may well be that the amendments to the Ontario Landlord and Tenant Act in 1970 restricted the property rights of landlords somewhat but substantially improved tenants' security of tenure so that by some utilitarian calculus the legislation created a net gain for society.

Table 3 -2

Tenants and Homeowners' Concepts of Fairness in Security of Tenure

Question: Should a landlord be able to refuse to renew a lease where the building is fully occupied and where	% answering "Yes"		
	Renters	Homeowners	Total
1. the landlord and his family wish to move into one of the units	30% n=57	48% n=106	42%
2a. one of the landlord's children wishes to move in to one of the units	13% n=79	29% n=80	21%
2b. the landlord's nephew wishes to move into one of the units	15% n=78	27% n=88	22%
2c. a good friend of the landlord wishes to move into one of the units	14% n=80	17% n=84	15%
3. the landlord would like to avoid one tenant's constant demands for building improvements	21% n=66	34% n=90	29%
4. all tenants are adults but one couple recently had a baby and the landlord wants to maintain an all adult building	32% n=79	43% n=80	37%
5. the original tenant has assigned the lease to a friend who has been paying the rent after the tenant moved out	44% n=77	49% n=83	47%
6. the landlord would like to convert the building into condominium apartments	42% n=68	51% n=79	47%

Source: Knetsch et al. (1984, Table 3, p. 34 and pp. 19-21).

9.0 ATTITUDES CONCERNING SECURITY OF TENURE

There is no doubt that legislation, with a time lag, reflects policiticans' perceptions of their constituents' values. What values do tenants and others hold regarding security of tenure? The results of a survey conducted by Knetsch et al. (1984) of tenants' and homeowners' attitudes on the conditions under which a landlord should be able to refuse to renew a lease are reported in Table 3-2. Several points should be noted. First, homeowners appear to identify quite closely with tenants, although they were more favourable to the landlord's interests than were tenants. Second, the only cases where at least 40% of tenants would allow the landlord to refuse to renew the lease were in situations where a tenant had sublet or assigned his lease, or the landlord wished to convert the building into condominiums. See Q5 and Q6 in Table 3-2. Third, 70% of tenants believe they should be able to remain even if the landlord wants the unit for himself or his family (Q1). They feel even more strongly where he wants to rent it to one of his children, a nephew, or a friend (Q2).

Knetsch et al. (1984, p. 25) conclude the data in Table 3-2 "appear to suggest that community standards grant the tenant a right to almost indefinite tenancy". They continue, "the housing rental agreement is perceived as an open ended arrangement [from the point of view of the tenant] rather than a time-limited one at the end of which the landlord is free to dispose of the property as he wishes". However, the rights of a tenant in a particular unit cannot be passed at will to another person. This may be explained by the phenomenon of loss-aversion: being forced to vacate a dwelling is a considerable hardship, which cannot be imposed at the landlord's whim. The tenant's friend, however, is not in the same situation and does not deserve the same protection.

It should be emphasized that these concepts of security of tenure apparently do not hold where an increase in rents, reflecting the landlord's increased costs, will require some tenants to move out because they cannot afford the higher rent. Knetsch, et al. (1984, p. 23) found that 54% of tenants (and 64% of homeowners) said the landlord should be able to increase the rent under these circumstances. See Table 2-1 in Chapter 2.

10.0 THE SOCIAL COSTS OF SECURITY OF TENURE

Security of tenure provisions to assist tenants in dealing with large increases in rent (i.e., above the CPI and particularly above the increase in a household's income) involve a problem in risk bearing. Rent regulation imposes much of the cost of risk bearing on landlords rather than on tenants. Property owners at the time the controls are imposed pay the insurance premium. Fallis (1984, pp. 34-35) points out that while increased security of tenure may result from limits on unanticipated increases in rent, the tenant's security of tenure may be reduced by the fact that rent control greatly increases the incentives of landlords to convert their buildings to non-rental uses or to demolish and rebuild outside the controls. I would note that rent control or the threat of rent control increases the risks to landlords and this will be reflected in a higher required rate of return on rental housing so that the social cost of such housing is thereby increased. However, much of this increased cost may be capitalized and fall on rental property owners at the time controls are imposed or widely anticipated.

Who should bear the risk is a distributional question. It is an ethical one, although it may be more efficient (lower total costs) for one party to bear such risks than the other. If the shifting of such risks from tenants is a social objective, should the cost not be borne by society rather than one specific group?

What are the social costs of more stringent security of tenure provision? Landlords will incur higher costs in collecting overdue rents. They will have higher costs in evicting tenants for cause, as lengthier and more elaborate procedures must be employed. Before noisy or destructive tenants can be evicted they may have caused their neighbours or their landlord considerable inconvenience or expense. Both landlords and tenants will be constrained from actions that would more closely match their preferences for risk.

In the long run under competitive conditions, these costs will be borne by tenants, but as we have noted, not all tenants value stringent security of tenure protections more than their costs. Moreover, because the costs of security of tenure provisions are hidden, there is the possibility that people will come to believe that they can create and enforce new rights for nothing.

If there are social costs, there are also social benefits. Changes in statutes that establish an efficient and fair means of resolving landlord-tenant disputes that are not associated with rent increases may be of considerable value to both tenants and landlords. As I discuss in Chapter 3 of Stanbury (1985), the concept of justice as fairness is a strongly-held value (Rawls, 1971). Hence, efforts to curtail arbitrary unreasonable actions by one party to the rental contract will be widely deemed to be desirable. In a world of imperfect knowledge, costly information and significant transaction costs, clear "rules of the game" embodied in statute can improve efficiency in exchanges, particularly where the parties have a rough parity of economic power. At the same time, the creation of new rights rather than simply the provision of information and the reduction of uncertainty as to both parties' legal rights, can also require more resources for dispute resolution. Justice, like everything else, is not free. Elaborate public or private processes for dispute resolution can be costly (Sowell, 1980, Ch. 9). Once again, we face what Arthur Okun (1975) called "the big trade-off" between equity and efficiency.

11.0 EVIDENCE OF TENANT MOBILITY AND SECURITY OF TENURE

Fallis (1984, p. 31) makes a good point when he notes that we have little empirical evidence on the security of tenure of tenants. It is particularly important to identify the incidence of involuntary moves and their proximate causes. Just how frequently must families incur the information and transactions costs associated with moving because of rent increases or other actions beyond their control, holding all other variables constant? Surely this is the crux of the problem.

Data on mobility are difficult to obtain and data which give the reasons why households move are extremely rare. To obtain some idea of the frequency with which Ontario renters move we can consult data collected for the Ontario Ministry of Housing. It consists of surveys of several thousand private rental households in several Ontario cities over the period 1976/77 to 1982/83. Table 3-3 reports mobility in terms of the percentage of renters who have moved during the previous twelve months.

Several points should be noted. First, mobility rates appear to be quite high -- about 40% of tenants surveyed had not been living in the same unit 12 months earlier. However, this measure does not provide any indication of how long those who had not moved in the past twelve months had been living in their present accommodation. For example, the survey by Knetsch et al. (1984) of over 500 Toronto renters in 1984 revealed that 31% had been in the same unit for more than five years and 30% had been in the same unit for between two and five years.[11] Similarly, a survey of 293 tenants in Scarborough in 1984 found that 25% had lived in their present building for more than five years, 27% had been there two to five years, and 17% had been there one to two years.[12]

Second, mobility rates, as reported in Table 3-3, appear to have declined since rent controls were enacted in Ontario. For example, the fraction of tenants who have moved in the previous year in Metro Toronto decreased from 41% in 1976/77 to 29% in 1980/81 and 1982/83. While a similar decline was found in London, the decline in other cities was not as great. Most analysts argue, particularly on theoretical grounds, that renter mobility will decline under

Table 3. - 3

Renter Mobility Rates -- Percentage of Tenants Who Have Moved Over the Previous Year

Municipality	1976-77	1977-78	1978-79	1979-80	1980-81	1982-83
Metro Toronto	41 %	33 %	36 %	33 %	29 %	29 %
Hamilton	40	33	37	37	36	N/A
London	55	49	49	49	45	41
Windsor	N/A	N/A	47	44	43	N/A
Ottawa	43	40	40	40	39	N/A
Thunder Bay	44	46	49	47	43	N/A
Sudbury	39	40	41	40	38	N/A
Kingston	N/A	55	N/A	N/A	N/A	N/A
Sault Ste. Marie	N/A	45	N/A	N/A	N/A	N/A

N/A = Not Available; city was not surveyed at that time.

Source: Ontario Ministry of Municipal Affairs and Housing, Rental Market Surveys (Toronto: Ontario Queen's Printer, various years).

rent control, particularly for those living in controlled units. Cullingworth's (1981, pp 16-20) review of the literature suggests "the evidence is decidedly thin and certainly not all one way".

Data on the reasons why renters moved during the previous year are given in Table 3-4. For the four Ontario cities over the period 1977/78 to 1980/81, about one-half of the movers had rented a different unit within the same city. We don't know why these people changed their place of abode, e.g., we don't know if they were evicted for bad behaviour or moved because of a rent increase or because they needed or could afford a larger unit.

About one-fifth of movers had been living in the same city, but were not renting a year prior to the date of the survey. About 30% of movers were living in a different city a year prior to the date of the survey.

Did the movers experience a higher or lower rate of rent increase during the year? The survey for the period 1978/79 found that the median increase for movers and non-movers was not statistically significant with the exception of Toronto. There, movers had a median increase of 7.5% while that for non-movers was 5.8%. However, the Ontario Ministry of Housing (1980, p. 17) points out that the distributions for three other cities "show substantial differences... and all the differences indicate that mover units are subject to a greater incidence of high percentage rent increase (greater than 10%) than are non-mover units". (For more detail, see Stanbury and Vertinsky, 1985, Ch. 6.)

This information should not be construed to suggest that the cause of a move is a higher than average rent increase. The data do not permit us to determine cause and effect. The data also do not tell us if tenants moved voluntarily or involuntarily in response to some (non-rent) action by a landlord. Unfortunately, we have only one or two measures of the extent of security of tenure problems whether or not they are related to rent increases or to actions by landlords unrelated to the level of rent. The first is reported in

Table 3 - 4

Reasons Why Renters Moved, Selected Cities in Ontario, 1977-78 to 1980-81

Mover's Previous Situation 12 Months Earlier	Toronto				Ottawa				London				Hamilton			
	1977-78	1978-79	1979-80	1980-81	1977-78	1978-79	1979-80	1980-81	1977-78	1978-79	1979-80	1980-81	1977-78	1978-79	1979-80	1980-81
Rented Different Unit Within Same City	18 %	18 %	16 %	22 %	17 %	22 %	17 %	24 %	24 %	20 %	23 %	30 %	15 %	15 %	17 %	N/A
Lived in Same City But Did Not Rent at End of Survey Period	7	9	7		9	6	7		10	11	8		9	8	7	N/A
Lived in Different City at End of Survey Period	8	9	11	6	15	11	12	12	16	18	18	15	13	14	12	N/A
Total % of Movers	35	36	33	29	40	40	37	46	49	49	49	45	37	37	37	N/A
Sample Size	1,177	745	765	750	1,065	722	611	569	439	845	729	745	1,097	567	611	N/A

N/A = Not Available; city not surveyed at that time.

Source: Ontario Ministry of Municipal Affairs and Housing, Rental Market Surveys, (Toronto: Ontario Queen's Printer, various years).

Table 3 - 5

Reasons for Moving Between October 1980 and October 1981, Ontario Municipalities

MUNICIPALITY	AFFORD-ABILITY (%)	CHANGE IN SPATIAL NEEDS (%)	LOCATION (%)	NEW HOUSEHOLD FORMATION (%)	QUALITY (%)	TENURE CHANGE IN PREVIOUS UNIT (%)	PERSONAL (%)	TOTAL (%)	SAMPLE SIZE
Metro Toronto	10.9	17.5	28.4	14.7	5.7	10.0	12.8	100	211
Hamilton	11.8	12.4	26.3	23.2	12.9	7.2	6.2	100	194
London	14.4	11.5	40.7	11.9	5.4	5.8	10.3	100	312
Windsor	11.0	16.2	33.4	14.0	5.9	8.5	11.0	100	272
Ottawa	12.6	14.7	35.7	14.7	9.2	3.4	9.7	100	238
Thunder Bay	8.5	10.6	38.3	18.1	6.4	6.0	12.1	100	282
Sudbury	10.7	12.3	34.7	18.0	4.7	6.3	13.3	100	300

Source: Rental Market Survey in Seven Ontario Municipalities - October 1981 (Toronto: Ministry of Municipal Affairs and Housing), p. 11.

Table 3-5 and is also based on a survey for the Ontario Ministry of Housing. Three of the seven reasons given by tenants for moving between October 1980 and October 1981 may be related to security of tenure considerations broadly defined.

Between 8.5% and 14.4% of the sample moved for reasons of "affordability". This may be attributable either to an increase in rent or to a decline in the household's income, perhaps due to unemployment. Between 4.7% and 12.9% of tenants who moved did so for "quality" reasons. Again we don't know if the quality of building services declined (e.g., failure to make repairs or maintain cleaning standards in common areas), or tenants wanted to upgrade the quality of their rented accommodations. Third, the survey found that from 3.4% and 10.0% of movers experienced a change in tenure in the previous year. But we don't know if, for example, their previous landlord converted his building to condominiums, or those surveyed were not renting a year earlier, i.e., they were homeowners or living with relatives. Finally, it may be that the "personal" reasons column conceals part of what we want to know, for example, eviction, conflict with the landlord resolved by voluntarily moving, or discriminatory behaviour by the previous landlord that forced the tenant out. The point is that these survey data in Table 3-5, helpful as they are, really don't answer the original question: how frequently must renter households move involuntarily because of the unilateral actions of landlords, including rent increases?

Our second bit of data on security of tenure is based on a study of landlords and tenants financed by the Ontario Law Reform Commission in 1968 -- two years before the major amendments to the Landlord and Tenant Act. Some of the findings were as follows:

- 9% of tenants had moved out of an apartment before the lease expired. The three most important reasons were: transfer of tenant to another city;

conduct of the superintendent; and poor health standards in the building. Only the last two reasons could be said to be attributable to the landlord.

- 8% of tenants had had their apartments entered without their permission.

- 0.1% of tenants had had their furniture destrained by a landlord, i.e., seized for non-payment of rent.

- 0.2% of tenants had been locked out of their apartment by a landlord.

- 4% of tenants had received a notice to quit (oral or written). In 94% of these cases the notice was in writing. The principal reasons were: tenants were behind in the rent; tenants were noisy; and tenants had children when prohibited by the landlord.

- 3% of tenants had been evicted -- but this number may be unreliable due to response bias noted in the report.

- 1% of tenants had had a bailiff sent to their apartment.

- 4% of tenants had had to pay for damage done to their apartment.

- 6% of tenants who had written leases (with 91% of the total) had had their rent raised during the term of the lease without being given a new lease.

- The average cost of moving from one apartment to another in the city of Toronto ($130) was about the same as the average monthly rent in the survey in 1968.

The significance of these data for the situation in 1984 is hard to identify given the fact that both economic conditions and statutory provisions have changed greatly. However, two points might be noted. First, the incidence of landlord-tenant problems associated with security of tenure seemed to have been confined to a small percentage of all tenants -- but this was at a time when vacancy rates were higher, giving tenants more bargaining power. Rents were not controlled either. Second, some of the 1970 amendments to the Landlord and Tenant Act were designed to deal with issues that were problems for a small to minute fraction of all tenants. For example, only 0.1% of tenants had had their furniture seized by a landlord; yet the landlord's right of distress at common law was abolished. Presumably this was done for other reasons.

12.0 COMPARABLE SECURITY OF TENURE FOR HOMEOWNERS?

In focusing on the tenant's security of tenure we may be inferring that homeowners enjoy a much higher degree of security of tenure. Particularly in light of changing economic conditions in recent years, homeowners incur substantial risks that can threaten their economic ability to stay in their homes. Homeowners' security of tenure will be influenced by the following:

- increases in interest rates on their mortgage;
- declines in the household's income;
- increases in property taxes; and
- increases in running costs (repairs, maintenance and utilities).

However, the largest threat to security of tenure consists of changes in the market value of the house itself. The recent recession showed that the market value can fall below the amount of the mortgage and wipe out the owner's equity. When unemployment occurs at the same time, the combination of the drop in income and the fall in house prices can result in families abandoning their homes. McFayden and Hobart (1978, p. 110) show that if the homeownership component of the CPI is recast on a user-cost basis to reflect housing as both a capital and a consumer good, it fluctuates much more than the cost of homeownership index as presently calculated. For example, the published homeownership index increased each year between 1961 (100.0) and 1976 (284.7). However, the revised user cost index went from 1961 = 100.0 to 51.0 in 1966 to 170.4 in 1970 to 77.7 in 1973 and then to minus 3.5 in 1974, then back to 114.6 in 1976.

These risks to security of tenure for homeowners from an inability to pay the mortgage payments do not apply to the 28.8% of homeowners in Canada that do not have a mortgage.[13] In urban centres of over 100,000 population however, where most tenants live, only 20.4% of homeowners are not burdened with a mortgage.

For homeowners with mortgages, however, the interest rate risk has become more important in recent years for several reasons. First, there was a steady rise in nominal interest rates reflecting persistent inflation. (Later, in 1984 and 1985, it became clear that real interest rates increased substantially.) Second, long term interest rates became more volatile. Third, and most importantly, the period over which the interest rate on mortgages is fixed has shortened dramatically. In the 1960s mortgages often had the interest rate fixed for 20 or more years. In the early 1970s, interest rates were fixed for five years although the amortization period was usually 25 years. In the late 1970s and early 1980s mortgage interest rates were often fixed only for one, two, or three years. But during the periods of highest volatility the entire burden of risk bearing was shifted to the borrower by means of floating rates adjusted monthly. In short, homeowners as well as tenants can also be subject to economic eviction.

13.0 SECURITY OF TENURE LEADING TO RENT CONTROL

Security of tenure may be used to effect a form of rent regulation. Baar (1977, p. 631) points out that in 1974 New Jersey became the first state to adopt a law requiring that evictions from all residential units (except owner dwellings with not more than two units) be based on "good cause". The grounds for eviction were the following: the tenant's failure to pay the rent, provided that any increase in the rent is not "unconscionable"; disorderly conduct; negligently permitting or wilfully causing damage to the premises; breach of reasonable rules or covenants agreed to in the lease; refusal to agree, at the termination of the lease", to reasonable changes of substance in the terms and conditions of the lease...."; and the owner's intention to end rental of the premises either after citation for code violations which would be economically infeasible to correct, or as part of the "permanent" retirement of the unit from the housing market. Rent regulation was introduced under the provisions regarding "unconscionable" increases in rents as a defence against eviction. In many New Jersey communities rent increases became tied to certain increases in costs (e.g., heating fuel, taxes) and the consumer price index (CPI). However, because most local rent review boards kept rent increases below the increase in the CPI, landlords went to court to overthrow such regulation on the grounds that it denied them a fair return on their investment (Baar, 1977, pp. 668-676). The courts upheld their position and, in effect, instructed the rent review boards to adopt a type of public utility regulation based on a just and reasonable rate of return on landlords' investment. They were not, however, specific as to how this difficult task should be accomplished.

The point is, however, that middle-class tenants in large apartment complexes were able to obtain a form of rent regulation through a security of tenure approach even though tenants first organized in response to substantial rent increases and cutbacks in maintenance. The underlying issue may well have been the obvious fading of the American dream of home-ownership in the face of rising real costs of homes which were greatly outstripping increases in family incomes (see Johnston, 1982). When renting is no longer simply an intermediate step toward home ownership, rent increases and reductions in the quality of related services are vastly more threatening. Security of tenure takes on a new importance. It is not hard to understand the deep feelings that the particular dwellings can evoke in tenants. It is only partially captured in the words that speak of the importance of "home and hearth" and state that a man's home, however humble, is his castle. The Magna Carta did not distinguish between owned or rented houses.

Notes to Chapter 3

1. Federation of Metro Tenant's Associations, Brief to the Ontario Legislature on Bill 26, December 1, 1975, pp. 2-3.

2. NDP, "Caucus Position in Continuing Tenant Protection," submitted to the Standing General Government Committee of the Ontario Legislature, May 24, 1978, p.4.

3. Judge Pashman, in Inganamort v. Fort Lee, 120 N.J. Super. 286 at 293 as quoted in Baar (1977, pp. 651-55).

4. These amendments were preceded by what Klippert (1976, p.2) calls "the seminal study of residential tenancies in Canada". See Ontario Law Reform Commission (1968).

5. See Note 1, pp. 1-2.

6. See Note 1, p. 5.

7. Miron and Cullingworth (1983, Ch. 4) offer a more extensive discussion of security of tenure by examining other jurisdictions, e.g. West Germany, Massachusetts, New York, Great Britain, Manitoba, Surrey, British Columbia and Hong Kong. In Chapter 5 they discuss the proposition that "rent control redefines property rights".

8. Klippert (1976, p. 3), writing of the 1974 amendments to the British Columbia Landlord and Tenant Act, states that "security of tenure ... means a tenant is entitled, as a matter of right, to indefinite possession of residential premises". The landlord could no longer end a tenancy agreement unilaterally. Rather, to do so he must now demonstrate that termination was for reasonable cause.

9. The section numbers are those effective with the legislation in 1975. Many have since been changed.

10. Klippert (1976, pp. 23-27) explains how the 1974 amendments to the B.C. Landlord and Tenant Act abolished three common law doctrines: the right of landlords to destraint -- the seizing of the tenant's goods as security for outstanding rent without a court order; the doctrine of interesse termini — potential remedies for tenants who have not taken possession of leased premises; and the doctrine of implied surrender of a lease. See also Ontario Law Reform Commission (1968).

11. These data were included in the first draft of their study but not in the published version.

12. Scarborough Tenants Council, 1994: No Fixed Address (Toronto, 1984, mimeo), p. 24. For more data on tenant mobility, see Stanbury and Vertinsky (1985, Ch. 6).

13. Statistics Canada, Cat. No. 13-567 (for 1982).

Chapter 4

RENT REGULATION TO IMPROVE ECONOMIC EFFICIENCY

1.0 PROBLEMS ASSOCIATED WITH RENTAL HOUSING MARKETS

It is argued that the rental housing market is replete with special problems that undermine its functioning. Some analysts attach the term "market failure" to these problems although, as we shall discuss, strictly speaking, most of them do not fall into one of the categories of market failure that prevent markets from allocating resources efficiently. One of our primary tasks in the chapter is to classify the host of problems associated with rental housing markets into policy-relevant categories. See Figure 4-1 and the discussion below.

What are the problems associated with rental housing markets? Hulchanski (1984, Ch. 3) identifies two groups of factors that can prevent the rental market from being "competitive and efficient". The first group consists of imperfections in the rental housing market that prevent it from operating efficiently. He cites high transaction costs, high capital costs, heterogeneity of the housing stock, fixed location of rental units, durability, inelastic supply, minimum physical standards, and the particular nature of housing services. The second group of factors consists of constraints that provide significant barriers to the efficient operation of the rental housing market. These include inflation and mortgage interest rates, post-war income transfer programs, post-war housing programs, availability and the cost of land for rental housing, and the desirability of rental housing as an investment option.

Clayton Research (1984, pp. 19-22) provides a list of "problems and characteristics of Ontario's rental market which might be construed as rental market failures". Their list includes the following "potential types of market failure":

- Most rental markets in Ontario are very tight, especially in dwelling units at the lower end of the rent range. Despite the evident need for low rent dwellings, the market does not respond.
- Costs of construction and land are always rising. To stimulate new construction rents must rise substantially. But rents also rise for existing dwellings that were built at lower costs. The owners of these buildings reap abnormal or excess profits.
- In desirable areas of the city the price of land for housing gets bid up because its supply is fixed. Conversions, demolitions, and higher rents remove part of the rental stock available to low-income households.
- Long lead times are necessary for planning, approval and construction of new rental buildings. Hence, supply is very slow to adjust to changes in demand and, in the interim, landlords can impose excessive rent increases on existing tenants.
- Land use controls place restrictions on the areas within which new rental developments can be built. These controls cause delays, hinder competition and are said to be a source of market failure.
- Rental markets are essentially oligopolistic so landlords can collude to obtain higher rents than would occur in a free rental market.
- Some tenants such as the elderly or the disabled have relatively little choice in their accommodation. Such tenants are vulnerable to being charged rents higher than the market because of their low incomes, mobility problems, and limited information.
- Rental investors and financial institutions do not take adequate account of future inflation in both rents and the capital value of rental properties when assessing the economics of new rental investments. Therefore, for

this and related reasons, the minimum rent required is higher than it would be in the absence of this myopia.

Clayton Research faced the same issue that we must deal with here. It is to decide which of these problems are true market failures (defined in the next section), which are attributable to one or more types of government intervention, and which are inherent in the market under consideration and therefore largely beyond the control of government policy. They conclude their discussion as follows:

> Some of these, such as the effect of municipal regulations on the supply of land for new rental housing and the length of the lead times for new rental construction could be characterized as resulting from government actions. Others, such as the use of the price-rationing mechanism to distribute housing, require a political judgment as to whether market failure is involved. The fact that capital appreciation and future rent increases may not be adequately reflected in assessments of the viability of new rental projects, can be labelled institutional market failure. Still others, such as long lead times for construction, the possibility of oligopoly, and the vulnerability of some tenants due to information problems and high moving costs, are intrinsic to the rental market that may cause it to deviate from the competitive ideal (Clayton Research, 1984, p. 41).

2.0 WHAT IS A TRUE MARKET FAILURE?

Stanbury (1985, ch. 2) identifies and describes the various market failures as discussed in the economics literature. The list of market failures includes the following:

- public goods;
- externalities;
- imperfect competition and market power (including natural monopoly);
- "destructive competition";
- failure in the assignment of property rights;
- imperfect information (uncertainty); and
- transaction costs.

Only the last two categories appear to be relevant to the rental housing market and they are discussed below in sections 7 and 8.

Figure 4-1

Problems Associated With Housing Markets*

Problem	Classification of the Problem	Comment
. landlords possess market power	man-made or may be due to economies of scale (a tech. market failure)	Empirical evidence does not support idea that individual landlords have significant market power.
. all agents are not equally well informed	a true market failure	See text, section 7.
. transactions costs are significant	may be a true market failure	See text, section 8.
. high capital cost relative to income	nature of the market (not an efficiency problem)	Does not apply to rental housing from tenant's point of view (but does apply to owners) -- although rents can be a substantial fraction of income.
. heterogeneity of the housing stock	nature of the market	See text, section 5.
. housing is fixed in location	nature of the market	
. durability of the housing stock	nature of the market	
. supply is inelastic	nature of the market and due to government intervention	Problem is partly attributable to government regulation (zoning and building codes).
. minimum physical standards are required for rental housing	government policy, plus nature of the product	Problem is attributable to government regulation, buyers' tastes and tradeoffs between original and operating costs. See text, section 5.
. housing services are a complex commodity	inherent in the product itself, and a reflection of variation in renters' tastes and preferences	Other services are just as complex; investment characteristics irrelevant to renter. See text, section 5.
. persistent inflation and high mortgage interest rates	government policy and the actions of supply and demand for mortgage funds	Interest rates reflect inflation and government policy. Inflation is largely determined by government policy. Both have declined substantially in 1984 and 1985.

Fig. 4-1 cont'd

Problems Associated With Rental Housing Markets

Problem	Classification of the Problem	Comment
. post-war income transfer programs are adequate	government policy	Many arguments are run together here; the key proposition is that renter incomes haven't kept up with rents but the evidence provided for Toronto 1975-82 contradicts this.
. post-war housing programs favour home ownership	government policy	Public policy has provided substantial incentives for home ownership; subsidies to rental housing have been inefficient as Hulchanski (1984) admits.
. limited availability and rising cost of land for rental housing	inherent in the nature of the market; partly attributable to government policy	Hulchanski (1984) claims land for rental housing is "generally not available where and when it is needed". He fails to understand the role of the price system because it doesn't deliver the results he thinks it ought -- lots of low price, high quality rental housing for deserving low income families.
. rental housing is not a desirable investment option	largely a reflection of government policy or possible constraints imposed by government	Hulchanski (1984) argues demand is high for rental housing but development firms are unwilling to invest. The reason they are putting their money elsewhere is that the expected returns are higher. Rent controls strongly discourage investment in rental housing of new units that are controlled. When controls are extended to previously uncontrolled units, e.g., 1985, future investment without subsidies will all but disappear.

* The list of problems is from Hulchanski (1984, Ch.3).

Before I discuss the general concept of market failure it is necessary to indicate what we mean by economic efficiency. Economic efficiency is based on the idea of finding the "best" allocation of society's scarce resources, given the endowments provided by nature, including the state of technology, and given the tastes and preferences of the individuals who make up society. To distinguish among different allocations of resources economists employ the Pareto criterion. An action to alter the allocation of resources (re-arrange inputs and/or outputs) is said to be more efficient if it improves the welfare of at least one individual (in his own estimation), while not reducing the welfare of any other person in society. The most efficient allocation of resources (Pareto optimality) occurs when it is not possible to reallocate resources so as to make one person better off without making some other person(s) worse off. (As I discuss in Chapter 5, Pareto optimality or the most efficient allocation of resources may or may not maximize the welfare of society as a whole. This requires that we take into account the distribution of income.)

One of the more important results produced by economic theory is this: if all markets are perfectly competitive and certain other assumptions hold, then resources will be allocated in a Pareto optimal manner, i.e., allocative efficiency will be maximized. Market failures amount to a violation of the necessary conditions for markets to allocate resources as efficiently as possible, i.e., achieve Pareto optimality. For example, if negative externalities (e.g., pollution) exist, the private costs of producing some goods will be less than their total cost to society. As a result, too much of some goods are produced and too little of others are produced in the sense that the allocation of resources will not be Pareto optimal. Government action to tax the output of effluents, for example, could improve allocative efficiency: some individuals could be made better off without reducing the welfare of everyone else.

Because of the confusion surrounding the term market failure and the problems with its use in discussions concerning public policy, I offered a three-part classification of various problems that might be attributed to the rental housing market in Stanbury (1985, Ch. 2). I distinguished true or technological market failures such as those listed above from both government actions that act as impediments to the efficient functioning of markets and "man-made" constraints on allocative efficiency such as price fixing or the exercise of market power such as predatory pricing.

If the normative basis of advocating a particular policy is to increase the efficiency with which resources are allocated, then the operative question is whether the market in question is subject to a true market failure. We note also that where firms by collusive activity are able to jointly restrict output and raise price, i.e., impose a "man-made" constraint on the market, an effective competition policy could also improve allocative efficiency. But this possibility is ignored because, as Clayton Research (1984, p. 34) points out, "Ontario's major rental markets are not monopolies or oligopolies". Entry is easy; there is a large number of landlords. Abnormal profits wil stimulate new supply. However, "open competition may not ... exist in all of Ontario's rental markets". In some small towns a very few landlords may control all the available units.

In the case of most major rental housing markets there are only two candidates for market failure -- imperfect information and transaction costs -- and these are examined in more detail below in sections 7 and 8.

3.0 IS DISTRIBUTION, NOT EFFICIENCY, THE REAL PROBLEM?

As I noted in Chapter 1, what some people claim to be "the problem" may not be the real problem at all. Perceived problems may not even be the symptoms of the true problem. Moreover, what is seen as a problem by some is not seen as a problem by others. In the case of rental housing markets we appear to have an example of "problem displacement". The real issue for those who write about "the unique problems" of the rental housing market is not those features (e.g., durability, fixed location, capital intensive, etc.), but rather the outcomes that are produced by this market. I suggest that the real issue is the distributional consequences (who gets what) of rental housing markets. One can safely infer from some of the critics' analyses that they believe that market processes "fail" because low-income households are not able to obtain "decent quality" housing at rents that do not exceed one-quarter of their income. At the same time, some property owners, by luck or skill, are able to reap "inordinate" profits at the expense of the economically vulnerable. In short, the rental housing market does not meet the distributional objectives of many of its critics -- many of whom couch their arguments in terms of the idea that this market does not much resemble the textbook illustration of an ideal market.

It is desirable, therefore, to distinguish between problems in rental housing markets that result in economic inefficiency (whether allocative, technical, or dynamic) and those that are deemed to be problems because they produce distributional consequences unbecoming to certain observers. The fact is that a highly efficient market can produce distributional outcomes that are perceived as "unfair" or undesirable in some sense. Hayek (1976, p. 71) emphasizes that while it is logical to require that the rules under which the market "game" is conducted be fair, "it would be nonsensical to demand that the results for the different players be just. They will of necessity be determined partly by skill and partly by luck."

In Chapter 2 it became clear that there is a sizeable group of renter households who have an affordability problem -- their incomes are insufficient for them to be able to afford adequate housing on the private rental market without having to cut back expenditures in other important areas.[1] This fact, however, does not constitute evidence of market failure in the technical sense. There is nothing in the theory of efficient markets that says the "needs" of every household -- no matter how deserving -- will be met by perfectly competitive markets. A "shortage" of housing for low-income families is not a market failure although it may be a significant political problem and perceived to be a problem by those not directly affected. Sowell (1980, p. 176) reminds us that "all 'shortages' and 'surpluses' are at some given price and not absolutely in terms of the scarcity or abundence of the item in quantitative terms".[2] Moreover, "there is no such thing as objective, quantitative 'need'. Whether with airports or apartments or a thousand other things, how much is 'needed' depends on the price charged" (Sowell, 1980, p. 190).

Some critics of how the rental housing market functions are not enthusiastic about leaving the market alone and having the government provide cash transfers or subsidies to low-income households. From an efficiency point of view, lump sum taxes and transfers (subsidies) will have the least adverse impact on the allocation of resources. Such an approach, however, has a lamentable weakness in political terms. It makes redistribution highly visible and thereby politically more difficult to effect. Not surprisingly, the potential beneficiaries of redistribution prefer to build directly into market processes the means to achieve the desired results in distributional terms. Consequently, it is frequently the case that large distortions are also built into market processes. See , for example, Lermer and Stanbury (1985).

4.0 PROBLEMS ATTRIBUTABLE TO GOVERNMENT POLICY

It is essential to distinguish between problems caused by government action and those that are due to forces exogenous to government and that may be ameliorated by government action. For some observers of the housing market, it is the myriad government actions in the past and the promise (threat?) of additional actions in the future that constitute the most important source of problems in the rental housing market. In their view, the issue is "regulatory failure", not market failure. Therefore, it is suggested that the solution to this type of problem lies in less, not more, government intervention. For example, Clayton Research (1984, pp. 51, 54, 58, 60-62) makes the following points in this regard:

- rent control in Ontario "has had a severe impact on the private rental market's ability and willingness to respond to excess demand with the construction of new rental units"; "rent regulation could not stimulate new rental supply";
- "rent regulation cannot properly address delays and higher costs caused by municipal regulations";
- "new sources of supply, not rent regulation, are the best answer to monopolies and oligopolies";
- "information and assistance could protect less mobile tenants better than rent regulation could"; and
- "rent regulation is part of the problem of inadequate account being taken of future rent increases and capital appreciation in assessing new rental projects".

Stanbury and Lermer (1983) show how direct regulation has been used in a wide variety of industries (agriculture, airlines, trucking, taxis, railroads, broadcasting, telecommunications) primarily to redistribute income rather than to improve allocative efficiency. Indeed, regulation often has a substantial adverse effect upon economic efficiency.

In Figure 4-1 we have listed all of the problems associated with rental housing markets mentioned by Hulchanski (1984, Ch. 3). It is clear that, *a priori*, very few are true market failures. A number of the problems appear to be government-made. For example, persistent inflation is largely attributable to macro-economic policy, including the government's control over the money supply and fiscal policy. It is not attributable to market failure. This is not to say that the government's inability to provide a more effective macro-economic policy (i.e., full employment and reasonable price stability) does not produce an adverse impact on rental housing markets. Obviously, this market is more sensitive to rising interest rates than many others. For low income families their ability to purchase adequate rental housing depends, in large part, on the overall level of unemployment. On this score, Canada's performance has been far worse than the U.S., for example, over the past decade or so. Transfer programs are usually a poor substitute for a steady job in terms of a household's ability to pay market rents -- or even controlled rents. Endemic inflation and unemployment, however, are not the "fault" of rental housing markets.

5.0 UNIQUE OR INHERENT CHARACTERISTICS OF RENTAL HOUSING MARKETS?

It is argued the rental housing has a number of distinctive characteristics that make it difficult or impossible for the market of such housing to function smoothly and produce Pareto-optimal outcomes. The particular attributes that are usually referred to are the following: heterogeneity of rental premises and related amenities, durability of the housing stock, the fact that dwelling units are fixed in location, inelasticity of the supply of new housing units, and the convertibility of the housing stock into alternative uses.

Several questions arise. Are these characteristics unique to rental housing markets? Are these characteristics attributable to the nature of the good or service in question, i.e., given by nature? Are these characteristics "problems" only because rental housing markets do not produce the set of outcomes the observer wishes to see? What effect could rent regulation have in modifying these characteristics that are said to be problems?

Hulchanski (1984, Ch. 3) argues that because each dwelling unit varies in age, size, state of repair, amenities, quality, and locational advantages each is, "in effect, a slightly different commodity". Hence, there are many submarkets for housing, not a single market selling a homogeneous commodity. It is true that the greater the heterogeneity of a product or service, the greater the information burden that is placed on persons trading in the market, particularly buyers, who usually possess less knowledge than sellers do. It is true also that with a homogeneous commodity buyers and sellers can obtain an enormous amount of information by simply knowing its price. But it is a mistake to assume that all the information relevant to buyers (or sellers) is summed up in the price. The complete transaction, from the buyer's perspective, requires knowledge of such other terms as the availability and cost of credit, timing and method of delivery, terms of the warrantee or guarantee, and related transaction costs, e.g., ability to trust the supplier and rely on verbal commitments rather than using a formal, written contract, and so forth. More important, the welfare effects of heterogeneity are very hard to determine if such heterogeneity is a reflection of differences in tastes and preferences.

The fact that there are a variety of submarkets for rental housing demarked by size, price, quality, location, etc., in no way prevents markets from working efficiently, provided the size of each market or market segment is sufficiently large to support enough buyers and sellers to ensure that competition prevails. What is essential in considering apparent heterogeneity in rental housing markets is the fact that all units are substitutable for each other in varying degrees. If a cluster of units, by definition different than all others, is over-priced, prospective tenants "vote with their feet" and rent elsewhere. Despite the apparent complexity of rental housing services due to their heterogeneity, the evidence seems clear that consumers (and sellers) are able to "price out" the differences in the attributes of rental units. For example, hedonic price indices can be constructed from transactions data together with information on the various attributes of rental units to explain a large fraction of the observed variation in the rents for various dwellings (see, e.g., Merrill, 1980, and Griliches, 1971).

Finally, we should note that the heterogeneity problem is in considerable degree inherent in the nature of the rental housing market. Each location, for example, has certain unique characteristics. As well, heterogeneity is a reflection of the wide variation in people's tastes and preferences. Everyone does not want to live in the same size, type, and design of rental accommodation.

The housing stock is clearly a durable asset and additional supply requires some time to produce. While the housing stock is a durable asset, the rental housing services produced by this asset are high perishable in the sense that if a rental unit is not occupied the services it provides are not storable. (The same is true for air travel, for example, although the production plant is highly mobile.< Contrast this to capital-intensive factories producing household appliances. What they produce in excess of current sales can go into inventory and be sold in the future when demand increases.

The durability of the stock may actually make planning by buyers and sellers easier, precisely because it takes considerable time to increase supply. Next year's stock consists of this year's stock plus new units coming on stream (the existence of which is already known) less "retirements" from the rental stock due to demolitions or conversions. It should be appreciated that if it takes three years to bring a new rental apartment block on stream in Toronto, for example, that the construction period would be only about one-third of that time. The rest of the time is taken up going through the regulatory process which is the creation of governments. Moreover, the "approvals" phase is subject to much greater variability than the construction phase. And it is the phase in which landowners and developers seek pecuniary gains when local governments, at the stroke of a pen, can rezone land and/or alter the allowable density and thereby confer large benefits on a few individuals.

Why is durability of the capital stock in rental housing said to contribute to market failure when the similar durability of steel mills, auto plants, pulp mills, and a host of other capital-intensive production processes is never discussed in similar terms?[4] In those markets durability and the long periods necessary to add capacity simply mean that short-term shifts in demand can result in periods of excess demand or excess capacity. But no one seriously proposes to regulate them to smooth out the periods of disequilibrium. In short, rental housing markets are far from unique on this dimension although many of the people writing about such markets are obviously unfamiliar with the characteristics of other markets. What may be unique about rental housing markets on the supply side is the amount and variability of government intervention that appears to both slow down the supply of new units in periods of excess demand and also to raise the cost of supplying new units. (See Seidel, 1978; Frieden, 1982; Karlin, 1982; Colwell & Kau, 1982; Mercer & Morgan, 1982; Frech, 1982; Hamilton, 1981; Eger, 1980; Dale-Johnson, 1981; Proudfoot, 1980; and McFayden & Johnson, 1981.)

Hulchanski (1984, p. 38), after pointing out that building codes establish minimum standards and raise the cost of housing, argues that "in addition to being a basic human need, shelter is a primary cultural good". He, in effect, blames society for having defined a host of additional minimum standards for a housing unit which go well beyond meeting the basic physical need for shelter. If this is true, how has the market failed? A market is a signalling mechanism to allocate scarce resources among competing ends. It does not formulate tastes -- it responds to them.

But by how much do building codes actually raise construction costs above what they would be in their absence? See Silver (1980). Industry observers note that in many, perhaps most, instances building standards do not bind, that the market demands and builders supply units built to standards well above that required by regulations. The biggest constraint of building codes is probably their slowness in incorporating newer, cost-saving technology, e.g., plastic pipe for plumbing. Moreover, in deciding on the building standards to be embodied in a unit, purchasers have to consider the optimal balance between initial cost and the size and timing of maintenance and repair expenditures. Which is cheaper — a roof with an original cost of $6000 and no maintenance for five years, then an average of $200 per year for the next 15 years, or a roof with an original cost of $3500 with average maintenance costs of $400 per year from year three to year 15 when it must be replaced?

How does the fact that the rental housing stock is fixed in location contribute to an information market failure? First, we should recognize that most capital-intensive production processes -- of which there are many -- have their plants fixed in location. One has only to think of the production of hydro-electricity, nuclear power, pulp, paper, automobiles, shoes, steel, all minerals, etc. Housing is not unique in this regard. Why do housing analysts make so much of this fact? Second, all production processes tied to a specific location for a considerable period substitute transportation services for potential efficiency of larger, but fixed, production plants to shape the markets in which they compete. The same is true of rental housing: it is obvious that tenants trade off travel time (and cost) for location (including neighbourhood amenities) and the amount of the rent. It is in the housing field that the concept of a "gravity model" was developed, i.e., the price of housing services, all other things being equal, will fall in proportion to the distance from the city's core which offer places of employment and concentrated shopping opportunities.

Third, while location may be fixed, the same building may be converted to provide alternative services, e.g., from residential to commercial space; from large units to smaller dwelling units. Such conversions are not costless, but this is also true of the annual model change-over in the auto industry or the retooling necessary when a stamping plant alters its equipment to make different metal parts. The principal problem lies in the constraints embodied in building codes and zoning controls. For example, the supply of rental housing could be increased greatly, quickly and at low real cost if areas of single-family dwellings were re-zoned to, say, duplex zoning. This is not done because of the opposition of middle-class homeowners who prize the perceived amenities attributable to low-density usage. Depending on how many single family dwellings are re-zoned, the owners may actually obtain a capital gain.

What are the implications of the fact that rental housing is durable (has a long economic life), takes considerable time to produce, and is fixed in location? These characteristics together mean that the short run elasticity of supply of rental housing is very low. As a result, in the absence of controls, rents in the short run will be determined almost entirely by shifts in the demand. Goldberg (1983, p. 53), referring to housing in general, states "supply (new plus existing units) cannot change very dramatically in any given year, or only any period time much shorter than three to five years". If supply is inelastic, then fairly small changes in demand can produce disproportionate changes in monthly rents when leases come up for renewal. Moreover, rents are affected in both new and long existing buildings. Obviously, tenants are most concerned by increases in demand that can produce a sharp rise in rents.

6.0 PROBLEMS AND SOLUTIONS: SOME CAVEATS

In practical terms, it is important to determine, not simply whether a problem exists, but how extensive it is. The literature on rental housing markets contains many discussions of various problems, but very little empirical evidence on some of them to permit others to ascertain the scope and intensity of the problem. Analysts that believe in the efficacy of government tend to argue that because some anecdotal evidence can be produced, government action is required. On the other hand, some authors do not examine the rental housing market in any detail, but prefer to rely on generalizations that are based heavily on theory. They tend to see much less need for intervention. The critical point, however, is that both "sides" often fail to provide empirical support for their conclusion. In addition, as I have noted, some analysts exaggerate the "uniqueness" of housing markets, hence the need for intervention.

Even if a problem can be demonstrated to be significant, it is not obvious that government action will produce a *net* gain to society in terms of economic efficiency. As I discuss in Chapter 5, I must determine whether the "game is worth the candle". Are the likely costs of government intervention, both direct and indirect, less than the costs of the market failure to be eradicated or ameliorated? The Economic Council of Canada (1979, p. 41) suggests that

> the present extent and nature of government regulation make it desirable to place the onus of proof of the efficacy of additional regulation on the advocates of greater intervention. The advocates of more regulation must be able to show that the benefits of regulation broadly defined to include the values of equity and individual freedom, exceed the costs of the circumstances to be remedied.

It is hard to disagree with the Council, in light of the enormous body of research on its effects, that "there is need for a new modesty about the effects of government regulation" (ECC, 1979, p. 41). Note that this proposition applies with equal force when the purpose of intervention is to alter the distribution of income. Recall the discussion on the efficacy of rent regulation in dealing with the affordability problem in Chapter 2.

While it seems clear that such true market failures as natural monopolies, public goods, and the absence of individuated property rights do not affect rental housing markets, it seems desirable to inquire more closely into at least two other forms of market failure in these markets: imperfect information and high transaction costs.

7.0 IMPERFECT INFORMATION

Mackaay (1982, p. 107) emphasizes that "information is the essential ingredient of choice, and choice among scarce resources is the central question of economics". The presence of uncertainty is another way of saying that we lack information. "Uncertainty is generally a source of disutility, and information is the antidote to it" (Mackaay, 1982, p. 108). Mackaay continues, "'Knowledge' is best seen as a substantial body of information collated and systematized for repeated use in the future." Information is a peculiar commodity. It is hard to define and its quantity is hard to measure. In many instances it is difficult to define property rights in information as a commodity or, if defined, to enforce them by means of current legal redress. The appropriability of information is usually a matter of degree. It is hard to keep information as a discrete, excludable, private good. Inspection prior to purchase is complicated by the fact that inspection may make the transaction superfluous to the buyer. Finally, information may have public good characteristics -- use by one individual does not curtail its usefulness to others. See Mackaay (1982, pp. 113-115).

As is emphasized in Stanbury (1985, Ch. 2), the heart of the information problem lies in

- the asymmetry in the level of knowledge between buyers and sellers,
- the shape of the cost function for acquiring information, and
- the size of the costs of imperfect information (ignorance) and whether or not they are reversible.

7.1 Asymmetric Information and Vulnerable Interests

Clayton Research (1984, p. 35) argues that some elderly or disabled tenants, because of immobility or unawareness of trends in the rental market, may be exploited by unscrupulous landlords who charge them rents higher than the going rent for similar units in the market. While some might consider this practice to be a form of rent "gouging", the problem in this context results from a severe imbalance in market power attributable to asymmetry in information and transaction (moving) costs. While exacerbated by periods of excess demand, the problems of elderly and disabled tenants will occur even in a "balanced" rental market with vacancy rates of about 3% to 4%.

Evidence of asymmetry in information among tenants as well as between tenants and landlords can be found in the substantial variations in price for similar units even in the absence of rent controls which create a controlled and an uncontrolled market. Steele and Miron (1984, pp. 24-25) state:

> Staranczak (1978) found that only 53 per cent of the variation in the rents for modest units in Ontario in 1971 was explained by characteristics such as size and location. Further, in a very careful study in which great attention was paid to identifying any possible quality variable which might explain otherwise unexplained differentials, Friedman and Weinberg (1982) concluded that a substantial amount of rent variation is indeed attributable to price variation. ...Some households get bargain units while others pay a premium.

It should be emphasized that studies using hedonic price indices cannot be used to show only asymmetric information among tenants. In some cases at least landlords are charging rents below the market-clearing equilibrium, either due to ignorance or because they are not trying to maximize profits. The existence of substantial variation in the price of rental units with similar characteristics does not mean that the rental housing market is not "workably efficient". That is, given the fact that actors have imperfect knowledge (are uncertain) and that information is costly, it would not pay any of them to purchase more information (admittedly imperfect) at the margin. Finally, one must question whether rent control can efficiently solve the problem of imperfect information in rental markets.

7.2 Do Capital Markets Systematically Underestimate Potential Returns on Rental Properties?

It has been suggested that capital markets which supply the long term financing for rental housing may be subject to an important market failure in the form of imperfect informaton or its complement, uncertainty. Specifically, do capital markets systematically underestimate the potential returns (annual income plus capital gains) on rental housing -- thereby raising its costs to tenants?

Rational decision making by investors in rental housing and by those supplying them with funds requires that inflation in future be taken into account. But uncertainty is pervasive; it is notoriously difficult to forecast the likely appreciation of rents and property values into the long-term future.

The presence (or threat) of rent controls makes this task even more difficult. For example, Smith and Tomlinson (1981) present evidence that the real value of rental properties declined substantially between 1974 and 1980. See also Campbell Sharp et al. (1984) for data for the period 1976-1982 and the data cited in Stanbury and Vertisnky (1985, Ch. 6). Moreover, the lay public often ignores the effects of the rate of time preference (discount rate) on what appear to be large gains in property values that are not received for 20 or 30 years. For example, the present value of the capital gain of $1 million received 25 years from now at a 12% discount rate is only $58,820. Of course, this gain is in the dollars of the year 2019 whose "spending power" is bound to be much lower than today's (1985) dollars.

Jones (1983), for example, concludes that the failure to deal properly with inflation with respect to rents and capital values lies in real estate financing markets, not in the rental housing market. As a result, investors (and lenders) demand higher economic rents and the quantity of rental housing supplied by the market will be smaller than in the absence of uncertainty concerning future capital values.

7.3 Conclusions re Imperfect Information

Information problems cannot be ignored in the rental housing market, but they must not be exaggerated. In the real world we do not have complete knowledge. Moreover, information is costly. The critical issue is whether buyers and sellers are equally ignorant or knowledgeable. However, information costs in the rental housing market seem to be much lower than they are in the ownership housing market. We must be careful not to think of the latter when examining the former.

We should note that the market has responded to the demand for more and better information about rental housing. We observe a number of information "middlemen" whose function it is to assist tenants and landlords in making efficient transactions. The most obvious is the newspaper which sells classified ads, primarily to landlords. The ads are often organized by area and by price category and size of the unit. This reduces the potential tenants' search costs. Second, there are rental agencies (often as adjuncts to real estate agents offices) which list rental units and provide more detailed information about each unit. The agency may even provide transportation services for potential tenants as they search among the alternatives. The personal knowledge of the agent about the neighbourhood, the quality of services provided by the landlord and even transportation routes and times can be greatly reduced the "information gap" confronting tenants and reduce the uncertainty in changing their dwelling. This is more important when transaction costs, particularly moving costs, are not negligible. The fact is that despite the fee a tenant pays for the agent's services, the tenant's net cost of search may be less than if he did the job himself. (It is not obvious who bears the actual burden even if the other party writes the cheque; it depends upon the elasticities of demand and supply.)

8.0 TRANSACTION COSTS

Hulchanski (1984, p. 33) argues that "transaction costs for housing are high relative to the equivalent costs for other commodities". He then defines them as "the costs of acquiring a good in excess of its market price". These include information costs to which we have referred above. These transactions costs apply to both landlords and tenants and include the following:

tenants

-outlays for information
-opportunity cost of search time and travel costs
-moving costs
-re-decoration outlays
-psychological and economic costs of disruption and altering patterns of travel, shopping, etc.

landlords

-advertising costs
-rental agency costs
-vacancy costs (revenue lost)
-risk of bad tenants (damage, non-payment of rent, noise)
-cleaning and decoration costs

Hulchanski (1984, p. 34) argues that "for markets to function efficiently transaction costs ought to be negligible and the costs for the buyer and the seller should be comparable". This statement is too strong on both counts. As we shall discuss below, the idea that in the reference standard against which actual markets are to be measured in terms of allocative efficiency there are no transaction costs is highly questionable (Dahlman, 1979). Markets can function quite efficiently in the presence of non-negligible transaction costs even where they do not appear to be comparable for both sides of the transaction. In fact, appearances as to who is bearing such costs are often misleading. The incidence of these costs, like that of an excise tax, depends upon the relative elasticities of demand and supply. Non-negligible transaction costs become more of a problem for the efficient functioning of markets where property rights are not well defined and individuated.

Transaction costs are as necessary in a market economy as are production or transportation costs. The issue with transaction costs is not whether they exist as a "fly in the theoretical ointment", rather it is whether, in fact, it is possible to reduce them by government intervention and thereby improve resource allocation in rental housing markets. As we noted above, it is often simply asserted that transaction costs are high in housing markets and therefore they "discourage mobility and slow down the response to changing market conditions" (Hulchanski, 1984, p. 34). It is essential here to distinguish between transaction costs in rental housing markets and those in the ownership market. They are clearly much higher in the latter for at least three reasons.[4] First, there is the commission (usually about 4 to 6% of the selling price) paid to real estate agents -- although it is not clear who bears this cost, buyers or sellers. Second, most buyers are also dealing in the capital market (acquiring a mortgage), hence their "closing costs" often amount to several percentage points of the purchase price. Third, there is usually a greater period of time to effect a transaction in the ownership market than in the rental market.

We must ask whether, in relative terms, the transaction costs in rental housing markets are that high. How do they compare to such costs in other markets? Consider, for example, the transaction costs associated with having a major surgical operation. It is difficult and time-consuming to find a top-flight specialist. Several visits may be necessary to obtain an accurate diagnosis and to identify the alternative courses of treatment. The days spent in hospital results in a loss of income, as well as pain and suffering during the recuperation period. Nor should the costs of eating hospital food be ignored.

Consider a second example, the purchase of a micro-computer. One could buy one over the telephone in a few minutes, but what is the likelihood it would turn out to be suitable for one's needs -- which are often ill-defined at the start of the process? Think of the complementarities involved: software (availability and cost), back-up service and advice, compatibility with other machines, reliability, resale value and adaptability to newer technology in the future, and so forth.

It should be obvious that as a ratio of the purchase price, the purchase of a major surgical procedure and a micro-computer involve transaction costs as high as, or higher than, rental housing. While the absolute amount of transaction costs for changing rental premises may be greater than the two examples, when assessed in relation to the total size and frequency of purchase, the transaction costs for rental housing do not appear to constitute an important source of market failure. Recall the example of moving costs in relation to a possible rent increase in the previous section.

Data on the mobility of tenants (as we have seen in Chapter 3) indicate enormous variation in the frequency of moves. About 40% of tenants in Ontario cities moved in the past year, while about one-quarter have lived in the same unit for five years or more (see Stanbury and Vertinsky, 1985, Ch. 6). The important point is that the more frequent movers, who probably have lower transaction costs, prevent landlords from exploiting any advantage they may have in transactions. There is an analog to the small fraction of price-sensitive shoppers whose switching behaviour keeps prices down to competitive levels for all customers.

If the level of transaction costs are simply a reflection of human beings engaged in exchange, then the critical issue is to find the mode of economic organization that minimizes this necessary cost which is analogous to production costs (see Dahlman, 1979). Economic change will alter transaction costs. Where such costs are large, parties outside the transaction also have an incentive to find ways of reducing such costs. Therefore, we must ask, if it is easier for the government to reduce transaction costs in rental housing markets than it is for actors in the private sector to do so.

Can the existence of moving costs permit a landlord to exploit a tenant? In our view, it is unlikely that moving costs per se, even including the information costs associated with finding other accommodation, would be sufficient to permit unconscionable increases in rent provided the rental housing was reasonably balanced.[5]

There are at least two reasons why this is true. First, the costs attendant to a tenant moving out are largely reciprocal. Hazlett (1983, p. 293) points out that

> the landlord is also a 'captive' in that the existing tenant may impose costs on the landlord by moving and leaving an expensive transition period to the owner. What practical experience suggests is that long-time tenants who have proven their civilized habits of citizenship and bill paying are generally rewarded with fewer rent hikes than newer, more transient customers.

Second, while moving costs can be large in absolute terms (depending upon the size of the household, the extent of its furnishings and the distance moved), the rational renter will "amortize" them over the expected life of the difference in the rent on another dwelling. For example, if moving costs are $1000, the discount rate is 15%, the existing landlord can only increase his rent by about $12 per month before the tenant will move -- assuming the proposed increase is a perpetuity and that the tenant can find similar accommodations elsewhere at the same rent he is now paying.[6] Moreover, this calculation also assumes the landlord incurs no costs in finding a new tenant. Finally, the analysis ignores uncertainty in everyone's calculations.

Steele and Miron (1984, p. 24) conclude that the situation in respect to moving costs more closely resembles a bilateral monopoly than a simple monopoly. They then refer to "the widely observed phenomenon...of rent discounts associated with length of tenure (which) indicates that on balance there is a gain from being a sitting tenant".[7] Finally, they conclude by saying that "there is no reason in general to expect landlords to exploit sitting tenants because of the power conferred by the existence of moving costs, although it may happen in some instances".

Steel and Miron (1984, p. 25) point out that it would be useful for a government agency to maintain a list of suitable available accommodation to assist low-income renters without charge. Moreover, small landlords might find such a list helpful to them if the agency also identified creditworthy and reliable tenants. They note that the University of Toronto provdes a list of rental units for students.

9.0 WHAT CAN RENT REGULATION DO TO MAKE RENTAL HOUSING MARKETS MORE EFFICIENT?

Even if rental housing markets are subject to noticeable information imperfections and substantial (reducible) transaction costs, how can rent regulation overcome or ameliorate these market failures? First, rent controls are likely to make the path of future rent increases more predictable and their ancilliary provisions relating to security of tenure are likely to improve the position of the tenant relative to the landlord in terms of their contractual relationship -- see Stanury and Vertinsky (1985). In the latter case rent controls may not only confer new rights on tenants, but they may make them more aware of all their rights as tenants. In this way, the asymmetric information possessed by landlords and tenants may be reduced. In the former case -- creating greatly predictability for future rent increases -- the signalling power of prices will almost certainly be reduced.

Other effects may be far less benign. Because rents are controlled, in trying to earn an adequate return on their investment, landlords will have a strong incentive to alter the other implicit terms of the exchange. They will seek to limit outlays on maintenance, periodic redecoration, furnishings and the number of personnel running the building unless the particular system of controls offers cost pass-through provisions that help to set the general controls on rent increases. See Chapter 6. Despite the best efforts of regulators, it may be all but impossible to prevent the landlord from reducing the quality of the housing services he supplies unless there is a financial incentive to reward maintenance and repair expenditures -- see Stanbury and Vertinsky (1985). At the same time, when turnover occurs, the landlord will raise the non-price standards he uses by which to select tenants. In both cases the posted, legal rent does not convey the effective price of the transaction. Hazlett (1982, p. 280) puts it this way: "rent controls are, first and foremost, a legal jamming device placed to intercept the messages sent by consumers of housing to the providers of housing. This makes effectual communication as to the actual 'need' for housing impossible." Most importantly, long waiting lists for controlled units are not signals to investors to supply more controlled rental housing. (There is clear evidence that the vacancy rate in Toronto for units under controls is far below that for uncontrolled units -- see Stanbury and Vertinsky (1985, Ch. 6).)

At the same time, rent controls increase transactions costs from the perspective of the tenant. When controls really do work (i.e., keep rents below the market determined level), and have been in place for some time, tenants are loath to move because of the higher search costs involved in finding comparable accommodation. Hazlett (1982, p. 284) notes that in New York City, where controls have been in place since World War II, tenants have taken to reading the obituary column to find openings in the rental market in favoured areas. He refers to one young man who spent two years searching for a low rent unit in Manhattan, and "lucked out" when his girl friend was deported! (Stanbury and Vertinsky (1985, Ch. 6) note that tenant mobility in New York is one-half to one-third the rate in Ontario.)

Hayek (1981, p. 173) notes that rent controls "turn the occupation of a dwelling into a capital asset and encourage a tenant to hang on to his home even when he would surrender it at the reduced price provided he could be sure of finding another home when he wanted one". Because transaction costs have increased to both sitting and prospective tenants, mobility is reduced.[8] The offer of a better-paying job across town requiring a move may be rejected because of the important capital value of an attractive, low-rent apartment. The advocates of rent control tend to ignore such costs and those of tenants or would-be tenants who must spend inordinate amounts of time and effort finding preferred accommodation.

In summary, rent controls can't overcome the alleged market failures of imperfect information and high transaction costs. On balance, they almost certainly exacerbate these problems.

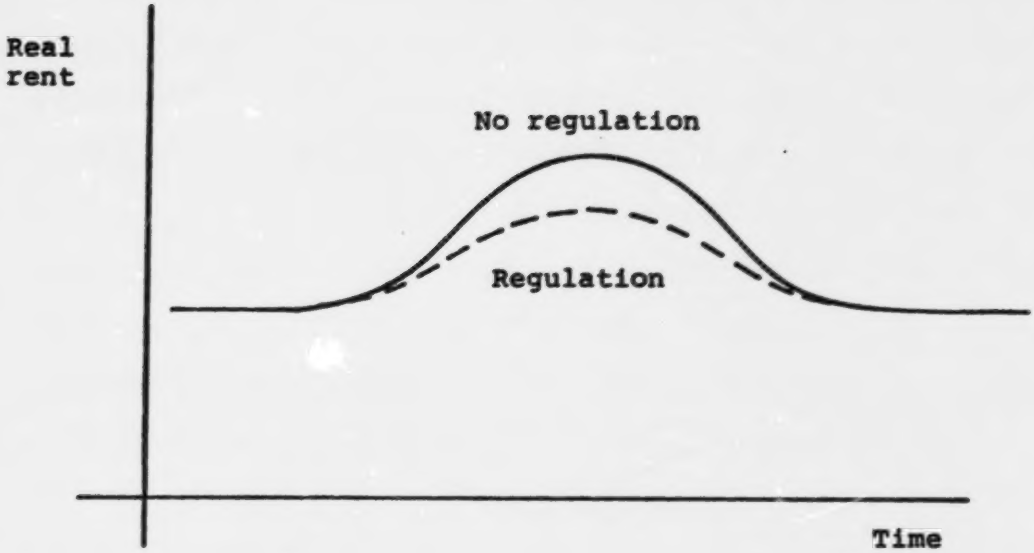
10.0 SMOOTHING THE PATH OF ADJUSTMENT

Arnott (1981, p. 11) argues that "there are circumstances in which temporary controls are desirable. If, for whatever reason, rents are expected to increase rapidly over a short period and then level off or fall, using rent control to smooth the time path of rents can reduce disruption in the market." He outlines the argument for rent control as a device to reduce the cost of economic change as follows:

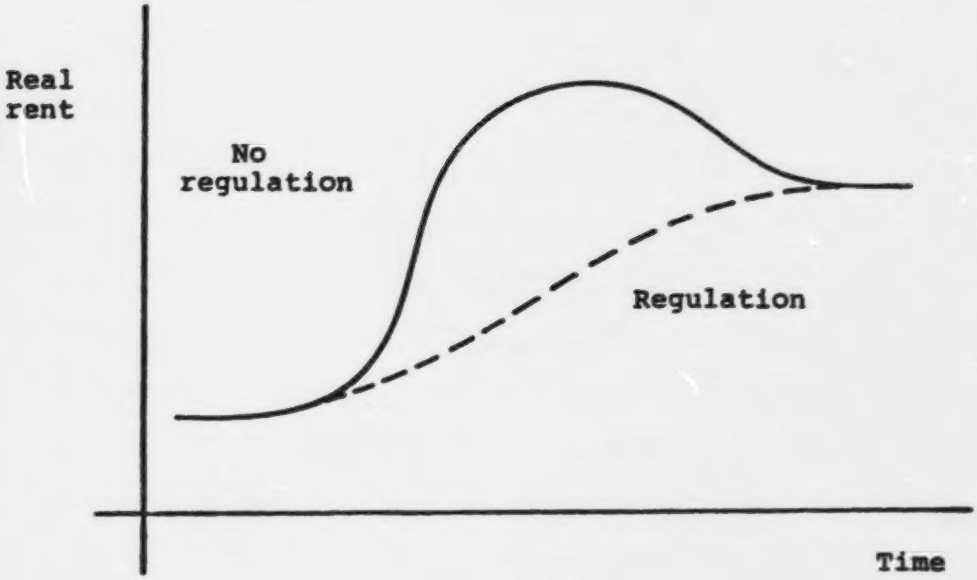
> ...rapid change is costly. The housing market is volatile, and because builders sometimes underestimate the strength of demand in the market, there will be periods when rents rise very rapidly. Builders will respond to this, and eventually rents will fall back to a 'normal' level. But in the interim, many tenants will be forced to move. It may be less disruptive to impose rent control and smooth the price adjustment (Arnott, 1981, p. 29).

George Fallis (1984, p. 35), a critic of rent controls in general, states that there may be a case for controls as follows: "if market rents are subject to wide fluctuations or if there is a suddent unanticipated change in the relative price of housing, it may yield a Pareto improvement to intervene and reduce the fluctuations or to alter the adjustment path of rents". Under this approach, tenants would be protected against sharp, extraordinary increases in rent, but not against finally having to adjust to inflation or a long run relative price change on the unit. In other words, rent control is to be used to alter the time-path of rents and thereby reduce the costs of adjusting to changes in demand and supply. Obviously, both equity and efficiency considerations are involved. Indeed, for many people, equity considerations are paramount. They want to prevent "gouging" in the face of excess demand.

Figure 4 - 2



Hypothetical Paths cf Rent Adjustment
No Change in Long-Run Rent



Hypothetical Paths of Rent Adjustment
to a Higher Long-Run Rent

Figure 4-2 provides two illustrations of how, in theory at least, controls could be used to alter the time-path of rents. One of the reasons economists are likely to be less critical of this objective of rent control: if only the adjustment path of rents is altered, there is little increase in the incentive to demolish or convert.

The alternative adjustment paths indicated in Figure 4-2 are deceiving. They are based on the crucial assumption that government (rather than individual landlords and tenants) knows with virtual certainty what the future equilibrium level of rents will be and when it will be attained. Even in what would appear to be the simplest possible case, such as the influx of visitors for a temporary event like Expo 67 in Montreal or Expo 86 in Vancouver, the government's ability to determine the level and timing of the new equilibrium seems problematical.

There is another almost opposite perspective on the problem of adjusting to economic change. It is the rational expectations approach in which individual transactors are assumed to be as well informed as government policy makers. In its strongest form, rational expectations theory suggests that any systematic macro-economic policy will be anticipated -- thus if policy makers respond to transactors' behavioural responses to prior policy changes, then macro policy becomes both ineffective and endogenous. Therefore, macro-economic policy cannot stabilize the economy, but only create more noise. This result follows from the idea that macro-econometric models used by policy makers to predict the consequences of policy actions assume that the parameters of their reduced form equations are invariant with respect to policy actions.

A basic tenet of the rational expectations approach theory is that individual decentralized transactors make the best use of available data so that subjective estimates of the data correspond to the objective probability distribution. However, rational expecations models lack a theory of the learning process by which information is acquired and processed.

The rational expectations approach assumes policy authorities have no informational advantage. While useful knowledge may well have a "habit of becoming available", the speed with which it does so is very important. Rational expectations models suggest that it is "as if" there were no informational problems in the real world. But, of course, there are.

The point for our adjustment path problem is that if the rational expectations approach is correct, the government cannot do better than individual transactors in finding the best (most efficient) path of adjustment to the new equilibrium, which itself is uncertain. Therefore, if rents are left alone in a period of excess demand, they will rise. However, assuming rational expectations, tenants will anticipate as well as any other public or private actors both the time path of rents and the next equilibrium. In light of their estimates of both kinds of data and their risk propensities, and the costs of moving to other accommodation, they will decide on the best strategy. Suppose, for example, the tenant "knows" (rationally expects) that his rent will rise by $200 next month, stay at that level for four months, then fall back to its present level, and that moving costs amount to $1000, then he will stay put rather than move. The problem is obviously more complicated: there are switching and reswitching costs, the current and future level of rent of alternative units and the shape of the probability density functions for each variable to be considered. Yet, according to the rational expectations approach, action by government cannot reduce the costs to society of moving from one equilibrium to another.

Although Fallis (1984) does not refer to the rational expectations approach, he emphasizes that economic theories are in an early stage of development concerning the efficient path of adjustment. Moreover, he suggests that the existing rent indices show no large fluctuations or sharp changes in the relative price of housing. Stanbury and Vertinsky (1985, Ch. 6) note that the behaviour of the rent component of the CPI was quite different than other measures of rent increases between 1973 and 1975. Fallis states that there is no evidence to suggest that an unregulated market will shift resources into housing too quickly. Therefore, he concludes that it is unlikely that a Pareto improvement is possible by altering the adjustment path of rents.

However, even if rent controls do not yield a Pareto improvement by smoothing the path of adjustment, they are able to prevent what are perceived as large, unfair increases in rent attributable to excess demand and inelastic supply. In short, rent controls are seen as a type of 'blow-out preventer". But this argument is based on concern about the distribution of income, not economic efficiency.

Notes to Chapter 4

1. Even conservative economists endorse the provision of cash grants to low-income households that are deemed to have an affordability problem. See Olsen & Walker (1981, pp. 276-278) and Walker (1975, pp. 201-212). Hayek (1976, p. 86), for example, concludes that "the distributive justice at which socialism aims is...irreconcilable with the freedom which the rule of law is intended to secure." At the same time Hayek finds there is no conflict with the rule of law for government to assure all of protection against severe deprivation, a form of insurance against extreme misfortune, given that it is provided *outside* the market.

2. More generally, we must note that any economic system is a system for "rationing goods and services that are inadequate to supply all that people want" (Sowell, 1980, p. 45).

3. Hulchanski (1984, p. 36) identifies two implications of housing's durability: the long-term consequences of short-term housing decisions; and the stock of housing is an important element in the determination of housing prices and conditions. These factors are not unique to rental housing.

4. See Gordon Pitts, "Hidden costs of moving house", *Financial Post*, (August 25, 1984, p. 16), who also talks about the tax consequences.

5. If there is excess supply, the landlord has almost no capability of taking advantage of moving costs.

6. The problem, in general terms is to determine whether the cost of moving (M) is less that the cost of staying (S) where

$$M = C + \Sigma \frac{Rm - Ro}{(1 + i)^n}$$

$$S = \Sigma \frac{R_1 - Ro}{(1 + i)^n} \text{, and}$$

C = fixed cost of moving

Rm = rent for equivalent accommodations elsewhere, i.e., if the tenant moves
Ro = the tenant's present rent
R_1 = the tenant's increased rent if he does not move
i = discount (interest) rate, i.e., the tenant's rate of time preference
n = number of periods over which the analysis is performed

7. Clayton Research (1984, p. 15) points out that the threat of tenants moving in a "balanced market" keeps rent increases from being excessive "since the costs associated with vacancies (loss of rent revenue, advertising and marketing costs and repainting and cleaning expenses) are significant. Indeed, there is evidence to suggest that, because of these costs, some landlords can be best characterized as turnover or vacancy minimizers rather than profit maximizers--as a result such landlords may deliberately underprice their accommodation so as not to risk unwanted vacancies."

8. See the discussion in Cullingworth (1981).

Chapter 5

MAINTAINING THE DIVERSITY AND BALANCE OF THE CENTRAL URBAN AREAS

1.0 INTRODUCTION

It has been argued that rent control is a useful policy to maintain the composition or structure of the central area of major urban centres, notably Toronto.[1] In particular, rent control can "freeze" the types of economic activity (commercial, industrial, residential), types of housing (ownership, rental; high-rise, single family dwellings), and the mix of residents in terms of income levels. Of particular concern to those who advocate rent control for this reason is that the low to moderate income households are able to continue to live in the central area of the big cities. Therefore, if rents are held below the market clearing level, and the conversion, demolition, etc. of the existing rental stock is tightly controlled, the physical and economic characteristics of central urban areas will not be sharply altered by relentless economic forces. Or so it is argued.

In this chapter I seek the origins of this argument in the battles over zoning legislation in Toronto, particularly as it has affected the so-called Central Area. This normative argument for rent control, as we shall see, is an ex post facto rationalization for a public policy already in existence. In other words, it was not made prior to the time controls were enacted in 1975, although the "maintaining the diversity" argument was used to justify radical changes in zoning legislation in the City of Toronto.

2.0 HOUSING POLICY AND ZONING REFORMS

The Planning and Development Department of the City of Toronto (1982, p. 27) states that "the City's chief housing objective is to maintain the diversity of its social fabric" and that "at present, continued rent review is essential to any viable housing strategy directed to this end". In addition, the City Council is committed to facilitating or producing directly housing for individuals and families of low-to-moderate incomes.

With the formal adoption of the Central Area Plan in 1976, it has been the policy of the City of Toronto to maintain or increase the diversity and balance in the central core area. What the planners wanted in the Central Area is a mix of

- households by size and type (families with children, singles, etc.),
- households by size of income (low and moderate incomes as well as the affluent),
- cultural and economic activities (theatres, shops, compatible industry, commercial office space, and housing),
- building sizes: individual houses, low-rise rowhouses, and apartment and office towers. "Aesthetically, the 19th Century residential street is one of the more satisfying features of this City" (p. B2-6), and
- ethnic neighbourhoods.

The latest wave of "reform" activities in the City of Toronto related to planning and zoning regulations can be dated by a handful of events in the early 1970s. In the fall of 1973 the City passed a number of "holding by-laws" designed to alter the terms of the Official Plan of 1969 by changing certain important provisions of local zoning laws. The most famous was the by-law that required any proposed building over 45 feet high to be subject to a public review procedure under which the the City used to obtain numerous concessions (space for housing, parks, setbacks, etc.) in exchange for a relaxation of the height restriction. Also in 1973, partly in response to the fight over the Spadina Expressway, the City opened a number of neighbourhood planning offices and began a systematic reassessment of planning guidelines and zoning regulations of the City, particularly the Central Area.

In December 1973 the Housing Work Group appointed by the City published its report, Living Room, which proposed extensive changes in both the planning and housing policies of the City. In 1974 the Core Area Task Froce published its extensive report and offered many recommendations that would drastically alter the Official Plan of 1969 as it related to the Central Area. In October 1975 the Central Area Plan Review Committee published its proposals for revising the Official Plan, most of which were adopted in the Central Area Plan in 1976. Reform ideals and policies had officially supplanted the pro-growth and greater specialization of land use for the Central Area. Instead, diversity and balance became the key words as planners sought to redesign Canada's second largest urban centre.

3.0 ANALYZING THE OBJECTIVES

The balance and diversity objectives for the core area of Toronto were repeatedly stated in the report of the Core Area Task Force (1974). The objectives are taken as self-evident and widely agreed upon, but they are not analyzed. For example, at page 6 of the Report it is stated that

> there is general agreement that a diverse, but balanced, Core Area is essential: that is, that the trend toward increasing office concentration in the Inner Core should not be reinforced and rather, that residential and mixed use development in the Core is desirable and should be encouraged. Included in this proposition is the idea that a variety of people -- families with children and low-income people as well as singles, childless families and upper-income people -- should now and in the future be able to find residential accommodation in the Core Area.

However, Joan Robinson (1983, p. 8) reminds us that

> the hallmark of a metaphysical proposition [such as this one] is that it is not capable of being tested. We cannot say in what respect the world would be different if it were not true ... It can never be proved wrong, for it will roll out of every argument on its own circularity; it claims to be true by definition of its own terms. It purports to say something about real life, but we can learn nothing from it.

It may be that the goals of diversity and balance are based on a nostalgic hungering for the status quo ante. The Core Area Task Force (1974, p. 10) states that "early Toronto (circa 1830) was compact and characterized by social and economic diversity. Most people lived near their place of work — sometimes in the same building. The texture of the City wwas fine-grained; lawyers and labourers often lived on the same street; prestigious residences and public institutions were found in close proximity to waterfront industries and diverse commercial activities."

The desire to stabilize the existing pattern of land use and activity is clearly articulated by the Task Force (1974, p. 48). Without new policies we are told that "the residential function, but also less expensive commercial, and less popular cultural facilities, will gradually disappear from many parts of the Core". Moreover, white collar and professionals would replace blue collar workers and thereby reduce the diversity of the area. Hence, "an area of maximum choice ... will become an area of very limited choice" (p. 49). The Task Force (1974, p. 49) made it clear it was interested in preserving existing neighbourhoods and noted that between 1951 and 1971 "much of the City's low rise family houses have been replaced by high rise, small unit, non-family apartments". The fact that the characteristics of households and their size had already changed very greatly during this period is not mentioned. Moreover, the Task Force (1974, p. 50) argued that in the Core Area, "low-rise family housing has been replaced not only by high-rise luxury apartments, but also by the expansion of central businesses and of ... central institutions ...".

Why should it be public policy to increase or maintain the diversity and balance of the core area? The Task Force (1974, p. 21), after celebrating its diversity for several pages, concludes that "the diversity and choice of activity characteristic of the Core Area is gradually being diminished [and] ... these characteristics are fundamental to the totality of the Core". Why?

We are never told. The Task Force states that the increase in apartment construction "has reduced the choice of housing accommodation in the Area, notably accommodation suitable for families, especially families with children and for people of low to moderate income". The Task Force (1974, p. 29) indicates that one of its objectives is "that there should be the widest possible choice of housing for the broadest possible range of people in the Core Area". Such housing is to be balanced against the "activities related to Toronto's position as a centre of national, provincial, and regional importance ... found in the Core Area, particularly in the Inner Core" (p. 21). The Central Area Plan Review (1975, p. B2-6) argued that without an extensive residential component, Toronto's downtown "would tend to be relatively lifeless and under-utilized during evenings and weekends. The transportation, amenity and other service needs ... would therefore be inefficiently and uneconomically utilized." In addition, in order to obtain greater diversity and balance, "industries whose operations would be compatible with, and not a nuisance to, adjacent residential neighbourhoods ... [ought] to be encouraged to remain or locate in the Core [thus] expanding the range of choice of employment opportunities in the Core for both people [sic] living in and outside the Area" (Core Area Task Force, 1974, p. 43).

There is no question that the Central Area was undergoing substantial change in the 1960s and early 1970s. In 1971 the Central Area had some 121,000 residents as compared with 712,000 for the City and 2,775,000 in the Metro area. (Metro's share of Ontario's population increased from 24% in 1951 to 27% in 1971.) The Central Area's population had fallen by 20,000 between 1951 and 1971, but the number of dwelling units increased from 30,800 in 1951 to 44,700 in 1971 (Central Area Plan Review, 1975, p. A-17). From 1961 to 1971 tenant-occupied dwellings in the City of Toronto increased from 44% to 58% of the total. In the Central Area, the fraction increased from 69% to 82%. In

Metro as a whole, tenants occupied one-half the dwelling units in 1971 (Central Area Plan Review, p. B2-23). Some 70% of housing units in the Central Area were apartments in 1971.

Between 1951 and 1971 the proportion of one-person households in the Central Area increased from 10% to 36% while the proportion of family households decreased from 80% to 48% (p. A-20). The average number of persons per dwelling unit in the Central Area decreased from 4.9 in 1951 to 2.8 in 1971. The proportion of non-family households went from 21% to 51% of the total (p. B2-4). "In 1951, people of low and moderate income inhabited all parts of the Central Area. By 1971, lower income housing was primarily available only in the residential neighbourhoods to the east and west of the Downtown" (p. B2-4).

The Housing Work Group (1973, p. 11) in its report Living Room, which first officially ennunciated the reform values of the early 1970s, urged that Toronto City Council adopt and clearly ennunciate the following goals: "the provision to all its residents of decent housing in a suitable living environment at a price which they can afford ... [and] the equitable distribution of decent housing in the City between income groups". In addition, the report urged that the City's housing goals also include "the preservation and improvement of existing housing and existing neighbourhoods, through the provision of financial and technical assistance as well as regulation" (p. 12).

4.0 THE CENTRAL AREA PLAN AND CORE AREA TASK FORCE

The Central Area Plan Review (1975, p. A-8) argued that by the mid-1970s in Toronto "there was the widespread feeling that the central city need not be a place only to work, but could and should be a place for people to live". It was also stated that the Central Area of Toronto was unique, "a rather special kind of urban environment characterized by a complexity and richness of form and structure not found elsewhere in the City or Metro area" (p. A-12).

The debate over the future of the Central Area had elements of a conflict between local interests and regional interests: "It has been felt by many [inner city residents] that the function of the Central Area as a city residence area, as an industrial area and as a focus for community life for City and Metro residents is in danger of being overshadowed by its function as a center for specialized service activity [office work] serving larger area interests" (p. A-35). The area would, by allowing continuation of greater specialization of land use, lose "the colour and excitement ... from its great diversity of function and variety of people". It would lose "some of the richness of experience and complexity of texture which have always been among the most attractive qualities of urban life" (p. A-36).

In terms of land use, the Core Area Task Force (1974, p. 67) endorsed the following objective: "to maintain and enhance the diversity of functions in the core area and to maintain and encourage a balance between the roles of the core area through the implementation of appropriate land use policies". With respect to residential land use, the Core Area Task Force (1974, p. 73) argued that "the continued existence of the core residential neighbourhoods as areas which provide housing suitable for families, and available to a broad range of income groups including those of low and moderate income, must be ensured". This was to be done by preserving the existing housing stock and offering legal and economic protection for low and moderate income homeowners and tenants.

The Task Force (1974, p. 88) declared that "land and housing are public resources and public necessities". It also proposed that the City of Toronto seek "to limit windfall profits accruing to private individuals as a result of land development, especially residential development, when those economic benefits of development are due, in part, to public activity, including activity in land, transit, zoning, intended for the benefit of the public at large."

The overwhelming official rhetorical concern for low-income households -- in the name of maintaining the social fabric of the city -- has continued and is illustrated by the City of Toronto's Planning and Development Department's (1982, p. 30) review of city housing policy 1976-81: "If diversity of socio-economic groups in the City is to be maintained, demand for centrally located housing by affluent households -- which one way or another will be satisfied -- should be met by means not requiring displacement of lower income households."

In the following statement, the Core Area Task Force (1974, p. 50) provides both a restatement of the diversity and balance argument, with particular reference to housing, but it also emphasizes the preservation of the status quo as justification for its position.

> Why are we concerned about these residential trends? First, from a social standpoint, we believe that in the Core, as in other parts of the City, there should be a mix of people and therefore a choice of housing form and housing cost. Families and low-income residents should not be squeezed out of the centre. We need low-to-moderate income housing as well as upper-income housing. We need family and non-family housing in order to maintain the diversity that has characterized Central Toronto in the past and that should characterize it in the future.

6.0 SHIFTING VALUES

In part, the values in the Central Area Plan of 1976 were a reaction to the 1969 Official Plan of the City of Toronto. The 1969 Official Plan "was designed partly in response to the belief that the Central Area was becoming blighted and that Toronto's core was following a similar course to that experienced by American cities" (Central Area Plan Review, 1975, p. B2-2 to B2-3). It is ironic that "by the early 1970s it was evident that most trends towards decline ... had been reversed" (p. B2-3). The manifest success of the 1969 Plan may have been the prime cause of the adverse reaction to it.

The 1969 Plan stated that "it is ... the policy of Council to encourage the concentration of financial and related business, of retail trade, of entertainment and the arts in the Central Area", and within the Downtown District of the Central Area, "Council will encourage concentration of commercial office buildings" (p. A-41). The Proposed Plan (1967, p. 17) held that the existing stock of houses could not be increased and would increasingly be taken over by those individuals and institutions better able to afford it. "Those families that have lower incomes will have the greatest difficulty in finding housing near the centre of the City, except where public housing is provided. It will be essential to build most of the housing for lower income families in the outer areas, outside the City of Toronto."

What caused the extraordinary shift in social values embodied in this 1967 document and those expressed in 1974 and 1975 planning documents? Did the growth-oriented plans of the late 1960s succeed all too well in changing the face of the central area? Did the pace of change produce a type of "future shock" reaction? Could affluence have increased so rapidly -- together with the prospects of even greater material prosperity -- that non-material things suddenly became of much greater importance?

The Proposals for the Central Area Plan Review (1975, p. A-34) noted there was "a growing apprehension about the wisdom of continued rapid growth and change as an essential element of urban life in the central city". But this was linked to changes in other values including the following:

> increasing concern about deterioration of the environment and the depletion of natural and energy resources; reaction against past patterns of urban development, particularly auto-oriented development and suburban sprawl created by the proliferation of single family subdivisions; growing concern about the continually rising costs of providing adequate urban services and facilities; changing attitudes about the distribution of incomes and other social goods among various sectors of the population, including those presently most disadvantaged by the system; and increasing concern with the

> preservation of neighbourhood and community values combined with a reaction against the uncertainty and instability generated by constant change (Central Area Plan Review, 1975, p. A-34).

6.0 PLANNERS' PREFERENCES

The Central Area Plan of 1976 was the first of Toronto's official plans to incorporate the City's housing policy which included not only the objectives to be met, but also a framework for implementation. The new direction was two-pronged: "restrictive and conservationist in neighbourhoods considered worthy of retention and improvement" ... [and] ... "the provision of family and assisted housing in appropriate locations elsewhere in the Central Area" (p. B2-11). The planners' preferences were articulated in great detail. For example, we were told in Central Area Plan Review Proposals (1975, p. B2-19) that housing units for families with children should contain two or more bedrooms and be situated "so that the main entrance to the unit is no more than three floors above grade or podium level, with an entrance direction accessible without mechanical assistance". It was held that "families with children need a particular kind of living environment not normally provided by high-rise towers". The planners said that direct access to grade provides increased surveillance, security and safety, and that a range of 60 to 75 children per acre is the acceptable maximum for most projects. In the case of non-family households, "facilities should generally be provided internally to a building since those areas where non-family housing is recommended might well be deficient of active, outdoor recreation facilities" (p. B2-22). In addition, the planners stated that the "Central Area would seem to be an ideal location in many ways for the production of special purpose housing for senior citizens and low-income single people" (p. B2-42).

It was also argued in the Central Area Plan Review (1975, p. B2-7) that renovation or redevelopment of old houses forced lower income tenants and owners out of the area and forced them to pay more for housing. Moreover, "the replacement of housing for low and moderate income persons is now almost exclusively performed by the public sector [therefore redevelopment] increases the burden on public resources ...". It should be clear that it is only a short leap from this thinking to the advocacy of retaining rent controls to 'freeze' the income structure of demand for central area rental housing. Rent control just became another means of preserving the structure of the neighbourhood in the ideal state perceived by the planners and their allies.

7.0 AN EX POST FACTO ARGUMENT

It should be emphasized that the argument that rent controls ought to be used to maintain the diversity and balance in terms of the incomes of households, tenure types, and land uses in the central area of Toronto was not present in 1975 when the imposition of rent controls was high on the agenda of local and provincial politicians. See Stanbury and Thain (1985, Chs. 6-8). While the Central Area Plan of 1976 strongly entrenched the balance and diversity objectives and resulted in actions to make them operational, rent controls were not in any way related to them. It appears that the yoking of controls to the diversity and balance objective amounts to an *ex post facto* argument to ensure that rent controls are retained. The linking of controls to the diversity argument is being used to buttress the "reform" values said to be at the heart of the Central Area Plan of 1976 and to justify the continuation of rent controls long after their original justification — to prevent 'gouging' -- has ceased to have much force.

The "rent control is needed to ensure diversity and balance" argument provides support for the proposition that regulation itself creates interests in its preservation that may not have been present when it was initiated — see Noll and Owen (1983). To continue the benefits of rent control in the form of lower-than-market rents, the middle class liberals have now connected it with another liberal/reform shibboleth, the idea that hands-on planning and detailed land-use regulation can be used to maintain the structure of the central area of Toronto in much the same way as it was in earlier times. The rallying cry is diversity and balance. The objective is to reduce the pace of change and to preserve a particular pattern of urban life. Diversity refers to land use, to the incomes of households residing in the area, to the types of dwelling units, and to types of tenure. Rent controls, we are told, are necessary to ensure that low and moderate income households can continue to live in the Central Area and perhaps to work there so as to reduce the private and public costs of transportation. Ideally, say the planners, members of these households should have a considerable choice of jobs within walking distance of their rent-controlled dwellings. Moreover, if private supply falters, for whatever reason, the City and the Province are exhorted to either provide public housing below its cost of production or to subsidize privately-supplied housing units.[2]

The overwhelming official rhetorical concern for low income households -- in the name of maintaining the social fabric of the city -- is illustrated by the City of Toronto's Planning and Developments (1982, p. 30) review of city housing policy between 1976 and 1981: "If diversity of socio-economic groups in the City is to be maintained, demand for centrally located housing by affluent households -- which one way or another will be satisfied -- should be met by means not requiring displacement of lower income households." The contrast with the Proposed Plan document of 1967 could hardly be greater.

8.0 AN ALTERNATIVE PERSPECTIVE

But is the desire to maintain the status quo in terms of diversity of economic activity, form, tenure types, and household income merely a hungering for the city of the past? Perhaps not. It may be based on a combination of the pecuniary and non-pecuniary interests of the advocates of the new policies. One can conceive of a city as a type of club, particularly in the case of longtime residents. They have settled in, formed comfortable and enjoyable patterns of behaviour, and they have both an economic and psychological stake in the way things exist at present. Change is almost always costly in psychological terms. Research indicates that the risk of loss is much more greatly feared than the failure to obtain the benefits of an opportunity lost -- see Knetsch et al. (1984). Moreover, as one's economic position is made secure, positional goods become the bases of social differentiation (Hirsch, 1976). Amenity values become more important as the marginal benefits of additional goods and services decline. The Core Area Task Force (1974, p. 149) described the amenity values of the core area as follows:

> We believe that the central part of Toronto is essentially a good place to live. It is close to downtown. Residents can walk or ride a bicycle or take public transit to work, to a movie, to a beer parlour, to the Market, or to the Museum. The range of different kinds of housing, stores, community services and facilities is abundant. The housing may not be suburban housing and there may not be a place to park a car but you may not need one. Most of the housing is low-rise and still appropriate for raising families. The neighbourhoods have distinctive characters -- many were built before or around the turn of the century. They presently provide housing for a very broad range of income groups.

If one is already benefitting from the present situation, why not try to preserve the characteristics of the neighbourhood or a section of the city one finds particularly congenial? If others, particularly those not now living in the area, have similar tastes, the economic value of one's position in the structure of the neighbourhood will increase. Therefore, like an Old Master, one can enjoy the amenity during one's lifetime and be sure of a large capital gain when selling out and moving on temporally or spiritually. The crucial point is that the existing stakeholders see the enshrining of the status quo in different terms than do future stakeholders. Future residents are not members of the Club. Their interests are given short shrift.

Notes to Chapter 5

1. This argument was advanced by Toronto Alderman Ron Kanter during the cross-examination of the author before the Ontario Commission of Inquiry into Residential Tenancies in October 1984. Subsequently, I sought to document the background of this argument for rent control.

2. Established in 1975 the City of Toronto's housing corporation, Cityhome, at the end of 1982 had some 3800 units in its portfolio (Shifting Foundations, 1982). About 1600 of these were rent-geared-to-income units, while the remainder were "market" units. Ontario Housing Corporation, at the end of 1983, owned 84,400 units (48,300 family units; 36,100 for senior citizens) and also had another 11,400 units under rent supplement agreements. In addition, OHC was providing rent-geared-to-income subsidies for more than 115,000 units. "As such, the corporation was subsidizing about one in every 10 rental households in the province, and one in every seven rental households in most of [Ontario's] major cities" (1983/84 Annual Report, p. 11). In 1983 OHC subsidies or losses on its own units amounted to $153 million. In addition, CMHC's share amounted to $146 million. Therefore, the average total government subsidy was $1429 per year per unit. For more detail on the scope and cost of public housing, see Chant (1985).

Chapter 6

FINDINGS, CONCLUSIONS, AND THE ROLE OF NORMS IN POLICY ANALYSIS

1.0 INTRODUCTION

In this chapter we draw together the principal findings and conclusions from the analysis of the normative arguments for rent regulation in Ontario. These are listed in point form in section 2 in order to simplify them and make them stand out clearly. In section 3 I address an important general issue in policy making -- the application of general principles, often derived from theory, to the facts of a particular case. We argue that the consequences of rent control depend very strongly upon the details of a particular system and how it is implemented.

In section 4 I continue the task of moving from the analysis of norms to the drawing of implications for public policy by examining some of the underlying reasons why rent regulation is such a contentious policy issue. Because we are trying to understand attitudes and feelings that appear to underpin more formal arguments, our discussion is necessarily more speculative. Our analysis includes a discussion of the possible reasons why rent payments are a particularly sensitive economic variable.

Section 5 delves more deeply into the issues involved in moving from our analysis of the norms underlying the desire for rent regulation to policy considerations. Three issues are examined: the point that the existence of a market failure or "distributional failure" is not a sufficient condition for government action; the need and difficulty of making trade-offs among several desirable objectives and among different groups who will "win" or "lose" as a result of policy choices; and the relationship between economic efficiency and society's welfare.

2.0 FINDINGS AND CONCLUSIONS REGARDING THE NORMATIVE BASES OF RENT REGULATION

2.1 Preventing Rent "Gouging" (Chapter 2)

- In terms of its emotional appeal, the most forceful argument for rent controls is that they ought to be imposed to prevent rent "gouging" or "unconscionable" increases in rent during periods of excess demand for rental housing. This argument is particularly strong when the economy is experiencing double-digit inflation and if the unemployment rate is rising, and if people have recently experienced favourable economic conditions so that the ratio of rent to income has fallen.

- For the advocates of rent control, the power of the "gouging" argument is strengthened if, in the absence of controls, the owners of existing rental buildings will reap large "windfall" gains during periods of excess demand or general inflation. Such gains are perceived to be "unearned". It might be argued that large rent increases attributable to demonstrable increases in the landlord's costs would be more acceptable. However, Knetsch et al. (1984) found that only 46% of renters and 60% of homeowners think that it is fair for landlords to be able to pass along increases in taxes, energy, and maintenance expenditures to tenants in the form of higher rents. They found that a similar fraction of tenants and homeowners thought landlords should be able to pass on increases in mortgage interest rates. Stanbury and Thain (1985) provide evidence that many of the advocates of rent control are concerned that higher interest rates on landlord's mortgages may be attributable to financial manipulation rather than the simple need to renew a mortgage at a time when interest rates are higher than the rate in the existing mortgage.

- There is no question that the primary argument preceding the imposition of controls in Ontario in 1975 was that a period of excess demand for rental accommodation was leading to rent "gouging". As Stanbury and Thain (1985) point out, the perception of sharp increases in rent occurred in the context of great economic uncertainty (e.g., rising unemployment and double digit inflation) following a period of years during which rents rose less than the Consumer Price Index and were less than the increase in nominal incomes. In other words, on average, the ratio of rent to income was falling.

- The empirical evidence on the size of rent increases during 1974 and 1975 in Ontario, Metro Toronto in particular, varies greatly -- see Stanbury and Vertinsky (1985, Ch. 6). If the rent component of the CPI is used, the price of rental accommodation (quality constant) rose only by 2% then 8% in those years respectively. If other CMHC survey data are used, which are biased upward, the increases in rents (quality not held constant) was at least double (and in some cases triple) these figures, i.e., 12% to 20% per annum.

- Several concepts of "gouging" can be distinguished. The one that appears to be implicit in the most common idea of "gouging" consists of sharp increases in rent not attributable to increases in cost. Hence owners of existing buildings can obtain large, "unearned" profits which are reflected in capital gains that can be several times the owner's original investment.

- Rent controls can eliminate what many people call "gouging" if (i) the allowed rate of increase is reasonably closely related to the landlord's increases in operating costs, and (ii) increases above the statutory rate (now 6%) must be cost-justified before a regulatory tribunal. As a result, landlords will not be able to earn "abnormal profits" attributable to excess demand situations. However, where higher rents and profits are eliminated, the effects on the long-term supply of rental housing in the controlled sector are very likely to be adverse. Even in the uncontrolled sector, long-term supply may be reduced to the extent that the existence of a control regime is believed to increase the likelihood it will be extended to cover new construction. This increases the riskiness of investing in new rental housing and raises its minimum supply price.

- Although controls may virtually eliminate the "gouging" problem in periods of excess demand, non-price rationing is necessary to allocate the "too few" controlled rental units among the "too many" prospective tenants. In the face of low vacancy rates, the latter will usually have to bear higher search costs, spend time on waiting lists for the most desirable units, or even try to get around the controls by offering "key money" to landlords or sitting tenants.

- Where future supply will be unaffected by rising rents (or it is public policy that it should be unaffected, e.g., wartime),[1] the efficiency consequences of temporary controls will be minimized.

- There are severe political, and to a lesser extent, practical difficulties in removing (phasing out) temporary controls designed to prevent rent "gouging" during what is believed to be a limited period of excess demand. Controls promised during the Ontario election campaign in July and August 1975 and enacted in December — to expire August 1, 1977 — have been regularly extended and made more elaborate (see Stanbury and Vertinsky, 1985, Ch. 5). Presently, all three political parties in Ontario appear to support the continuation of rent controls in some form.

2.2 Affordability (Chapter 2)

- The affordability argument is that rent controls, by holding rents below the market-clearing level for a substantial part of the market, will maintain or reduce the ratio of rent to income and thereby make rental units more affordable for low-income households. The argument is strengthened if persistent inflation is occurring and controls really do restrain rents below the market clearing level.

- Even some proponents of rent controls recognize that such controls cannot increase the supply of affordable housing, but argue they can prevent the existing stock from "becoming increasingly unaffordable" (see Hulchanski, 1984).

- The most common measure of affordability, the ratio of rent to income before taxes, is recognized as being a relatively poor proxy both conceptually and empirically. For example, from this measure it is all but impossible in practical terms to distinguish between rents that are "too high" and incomes that are "too low". They are two views of the same situation. Even if it is possible to distinguish the two situations by some arbitrary rule, it is probably not a meaningful distinction in terms of the implications for public policy.

- Implicit in the arguments for rent control as a means to obtain (maintain) affordable housing is the idea that housing is a "basic human need", and that "decent, affordable housing" is a "social right". There is considerable conflict over these propositions, particularly over how far they should extend. The core of the issue, however, appears to be a conflict over who should bear the cost of seeing that the benefit of this right to decent and affordable housing is achieved. It is clear that for a host of reasons, including scarcity itself, the market cannot provide the type, size and location of rental accommodation at a price deemed to be affordable by low-income households. Rent controls, however, throw much of the burden of paying for "decent, affordable housing" on landlords at the time controls are imposed. If such housing is a "social right", it has been cogently argued that the cost of fulfilling this right ought to be borne by taxpayers as a whole by means of transfers to renters, subsidies for the construction of rental units, or other forms of government assistance.

- Depending on the date of the estimate and the particular methodology employed, between one-sixth and one-quarter of renter households in Ontario experience an affordability problem. Renter households make up about 37% of all households in Ontario, but among the 10 Census Metropolitan Areas in 1981 the fraction of renter households ranged from 29.0% (St. Catharines-Niagara) to 47.7% (Ottawa-Hull). The rate for Toronto was 43.5%.

- Rent controls do not appear to be an effective or an efficient means of dealing with the affordability problem. For example, Marks' (1984b) analysis and that of the Ontario Ministry of Housing (1982) concludes that the Ontario system of rent controls probably has had little effect on the affordability issue and that rent controls are an inefficient policy of transferring income to low-income renter households (see also Stanbury and Vertinsky, 1985). There is the distinct possibility that affordability is an argument for rent control advanced by middle-class tenants as a means of evoking sympathy for the poor in order to advance their own interests.

- The rental housing market, like other economic markets, is a signalling system for the allocation of scarce resources among competing buyers. A market is a process to facilitate exchange because there are "gains from trade". Markets are not moral persons, hence they cannot assume the responsibility for ensuring that all tenants, including those with low incomes, obtain affordable housing of acceptable quality. In other words, the existence of an affordability problem is not evidence of a type of market failure. It appears that, given the constraints of technology, the endowments of nature and the existence of many forms of government regulation, a fraction of all families cannot obtain "decent, affordable housing". However, the fault lies either with distribution of income or with the facts of scarcity itself. Unfortunately, it may be that some part of the scarcity in the case of rental housing is government-made, and not entirely due to the niggardliness of nature. In any event, the problem remains and there is considerable support for public programs to ameliorate the problem. This argument does not rule out government performing one of its traditional functions, redistributing income in accordance with widely held views about "who should get what" in society. An important question is whether such redistribution should be done directly in the form of transfer payments or indirectly by imposing constraints on market processes.

2.3 Security of Tenure (Chapter 3)

- Security of tenure is a term that appears to incorporate several different things: (a) the imposition of rent controls in order to prevent economic eviction and to provide economic security of tenure; (b) legislation required to ensure that rent controls work, i.e., to prevent controlled units from moving out of the rent-controlled sector via demolition or conversion; and (c) the set of legal rules which determine the conditions under which (i) a landlord can evict a tenant during the course of a tenancy agreement, (ii) a landlord can refuse to renew the lease of a tenant who wished to continue in an occupancy.

- Security of tenure involves the balancing of rights and obligations as between landlord and tenant. Under certain circumstances, it can be an issue totally independent of rent control as, for example, when amendments were made to the Ontario Landlord and Tenant Act in 1970 and 1972.

- Security of tenure legislation is a necessary complement to rent controls. Without tenure rules landlords may be able to "get around" rent controls by evicting existing tenants for "non-economic reasons" in order to re-let the unit at a higher level of rent, or to demolish, convert, or renovate the unit and take it out of the rent-controlled stock. At the same time, tenants argue that without rent control, security of tenure is incomplete since they could be forced out of their homes by "economic eviction", i.e., where general rent increases make it difficult or impossible for them to continue to live in the same unit.

- The normative argument that rent controls ought to be imposed to provide security of tenure can confuse means and ends. It is acknowledged that if a system of controls is to be effective (hold rents below the market-clearing level), it must include regulations against actions by landlords to circumvent the controls, i.e., eviction to re-rent at a higher level, to demolish or to convert to condominiums, for example. These regulations, as we have noted, may be called security of tenure provisions. But the normative argument can also be reversed, namely that in order to provide tenants with a security of tenure right that is effective, controls on rent must be imposed in order to prevent "economic eviction". Therefore, in the first argument the end is rent control and security of tenure regulations are part of the means to effect controls. In the second argument, rent controls are part of the means to effect security of tenure -- "the right to stay put" except under certain highly restrictive conditions.

- Perhaps the hardest issue to be dealt with in the context of security of tenure is this: even with rent controls some households may not be able to pay the legal rent and still have enough income left to purchase a "decent standard of living" in terms of food, clothing, transportation, and other items. Should such individuals or families be able to stay in their rented home? The problem is most acute for older persons with low, fixed incomes who have resided in the same unit for many years and for the single, low-income mother with children in school. Another difficult issue is the stringency of the constraints placed on property owners, who, at the end of their tenant's lease, wish to have vacant possession in order to undertake major renovations, to convert the building to other uses (e.g., condominiums), or in order to demolish and build a new structure. The problem is exacerbated when we are talking about old, low-rise buildings in poor shape occupying a very valuable site.

- The principal arguments for security of tenure are based on (i) protecting the economic interest of the tenant in the face of sharp increases in rent that would otherwise reduce the standard of living of the tenant or result in the repudiation of the tenant's expectations concerning the ratio of rent to income; and (ii) the psychological importance of a particular rental unit as a home which provides a sense of security and emotional well-being attributable to stable place of abode. As the prospects of home-ownership dim, the importance of the terms and conditions under which one will occupy a specific rental unit become of much greater importance.

- Security of tenure for tenants raises serious questions concerning the nature of the property rights of the owners of rental accommodation. The advocates of "tenants' rights" often appear to ignore these questions by arguing either that landlords had "too much power under medieval property law" or that security of tenure is merely another form of "consumer protection" reflecting changing values in modern society. Radical changes in security of tenure rights can have a substantial effect on the economic value of rental buildings.

- The extent of the "security of tenure problem" in the sense of the frequency of involuntary moves by tenants attributable to the unilateral actions of landlords, whether or not they were rent-related, is extremely hard to determine. The frequency of moves among tenants for all reasons seems fairly high. For example, surveys of tenants in several Ontario cities indicate that 40% have moved in the previous year. About one-half of the moves involve a change of city, hence it is unlikely that such a move is related to the behaviour of a landlord. At the other end of the spectrum, we find (on the basis of limited surveys) that about one-quarter of all tenants have rented the same unit for over five years. Presumably, this is the group of renters that has the greatest potential interest in security of tenure -- in the sense of the conditions under which they may remain in place. The data available do not permit us to determine the fraction of tenants who experience security of tenure problems not attributable to their own actions. Economic conditions favourable to tenants (i.e., a fairly high vacancy rate) tend to make security of tenure a much less pressing problem. Competition among landlords improves the tenant's bargaining position in regulating the "rules of the game" (lease) with their landlord. When vacancy rates are not very low, the tenant's ability to switch landlords, although not without cost, is his best protection against arbitrary treatment by a landlord. Landlords also bear costs when tenants leave and new ones must be found.

- Greater security of tenure for tenants can have a cost to society and not all of these costs are borne by landlords. In fact, in the long run, tenants are likely to bear most of the cost in the form of higher rents which will embody a premium for what amounts to a statutory "insurance policy" against eviction except under highly restrictive conditions. Since not all tenants have the same risk propensity (desire for security of tenure), those that have a strong preference for security of tenure will be subsidized by those that do not.

- It is important to distinguish between changes in the Landlord and Tenant Act that merely clarify the nature of each side's rights and obligations and those that are designed to strengthen the position of tenants in terms of their security of tenure. There is no question that the former can do a great deal to reduce information and transaction costs thereby increasing efficiency and producing a net gain for society. However, a set of rights and obligations for landlords and tenants may be widely held to be unfair and yet may be efficient in the sense that the "rules of the game" are clear and few resources are used up by one party disputing the actions of the other. Actions to strengthen the position of tenants may increase information and transaction costs until a series of court decisions or legislative amendments make the new rules clear to everyone. But more importantly, in achieving what is seen as greater equity, security of tenure provisions may have the effect of imposing costs on landlords that are greater than the benefits conferred on tenants. Some would argue that such a move, therefore, is inefficient. But the central issue is the trade-off between the norms of efficiency and equity, i.e., "fairness" in the relationship between landlords and tenants.

2.4 Problems in Rental Housing Markets: Improving Efficiency (Chapter 4)

- It is argued by some that the market for rental housing suffers a host of problems that (unlike other markets) require government intervention in order to make the market function more efficiently.

- The "unique" characteristics of the rental housing market that are said to prevent it from functioning effectively are the following: heterogeneity of the housing stock, fixed location, durability, inelastic supply, minimum physical standards, high capital costs relative to income, and the complexity of housing services as a commodity. Our analysis shows that (i) none of these characteristics is unique to rental housing and similar characteristics can be found in quite a number of other markets for goods and services where their presence very seldom results in calls for government intervention; and (ii) none of these characteristics represents a true market failure. However, they may still be perceived as problems. More importantly, the possible government policies for altering the allegedly unique characteristics of the rental housing market do not include rent controls, at least in the forms they have taken to date. In fact, many of the "unique characteristics" are, in effect, exogenous constraints[2] inherent in the nature of housing services. Therefore, public policies to overcome these realities are very likely to have costs that exceed the benefits they may achieve. For example, it is hard to imagine how public policy can overcome the fact that housing is fixed in location — unless we all live in Winnebagos.

- A number of the "problems" associated with rental housing markets are largely attributable to other government policies which may be having an adverse impact on the rental housing market. These include the following: the inelasticity of supply (which is strongly affected by zoning laws); inflation and high interest rates (which results from poor monetary and fiscal policy); government transfer programs (which fail to provide sufficient help for low-income families); government housing programs (which have favoured home ownership by means of tax incentives, and have provided inefficient subsidies for rental housing); the lack of availability and rising cost of land (which reflects both its relative scarcity near the centre of large urban areas and the effects of zoning controls); and the desirability of rental housing as an investment vehicle (which depends on the risk-return combination for rental housing relative to other opportunities -- recognizing that various government policies, including rent control, can greatly influence the attractiveness of rental housing as an investment vehicle).

- The core of the critics' concern with the problems associated with the rental housing market is not really efficiency at all. It is that the rental housing market fails to produce the type of outcomes they implicitly desire. In other words, the real problem is not a lack of economic efficiency, but the distribution of who gets what in rental housing markets. Because the market produces an "insufficient" supply of "decent rental units" near the core of urban centres at rents that are "affordable" by individuals and families whose income is low, it is said to have "failed" or be subject to certain "problems". The problem, however, is better described as one of scarcity and a distribution of income that is definitely not egalitarian. The real resource costs of producing what some critics think the market should provide exceed 25% of the incomes of low-income families. The fact is that, all market failures or policy failures aside, we simply cannot produce 3-bedroom apartments in pleasant buildings near the centre of major cities to rent for $250 per month (which would assume a family income of $1000/month). We can, however, produce them for about three times that level of rent (the economic level of rent is strongly influenced by the level of interest rates). The market is a signalling system to allocate resources based on people's willingness to pay for what they want. Willingness to pay, of course, is constrained by one's income and wealth.

Ultimately, the income and wealth of individuals depends upon a society's real endowments, technology and personal skills. The problem is that we all cannot have all of what we want, and think we deserve, or believe we have a "right" to. If there are about 160,000 renter households in Ontario who have an affordability problem (a low estimate) averaging $200 per month, the cost of a cash subsidy would be $394 million per year. The average household's tax bill in 1983 would rise by about $133. Rent control, it should be noted, cannot effect such a narrowly targeted redistribution.

- There is some evidence to indicate that rental housing markets suffer from two true market failures: imperfect information and significant transaction costs. Imperfect knowledge (whose complement is uncertainty) is obviously present in rental housing markets, as it is in every market in greater or lesser degree. The case for government intervention, on efficiency grounds, is greatest when buyers and sellers are asymmetrically informed; where they face sharply different cost functions by which to acquire information; where information is not a strictly private good but is subject to free riders in a manner similar to public goods; and where the relative absence of information results in large, irreversible errors. While information failures are present in rental housing markets, they do not appear to be more extensive than for many other goods or services that we have no intention of regulating on this ground. More importantly, rent control as a form of government intervention can make little or no contribution to solving this type of market failure. Some form of mandatory disclosure system may reduce economic discrimination among tenants renting very similar units in the same building, but such a system -- if it produces benefits greater than its costs -- could be instituted quite apart from rent regulation.

- The argument that transaction costs are a market failure presents a more difficult theoretical problem. If Dahlman's (1979) approach is correct, the costs of search, obtaining information on the availability of alternative offers, of bargaining a contract, of policing or monitoring the terms of the contract to see that all elements of the bargain are fulfilled, and of enforcing any violation of the contract, all collapse into one category: the resources lost due to a lack of information. In Dahlman's (1979, p. 150) view, "no kind of known transaction costs can possibly generate anything looking like a Pareto-relevant externality". In other words, transaction costs are a reflection of the constraints of the real world in which human beings engage in exchange. To "wish them away" by abstracting from them in some ideal world is equivalent to wishing away production or transportation costs. Transaction costs, therefore, are to be included in the criterion (Pareto optimality) against which we measure distortions due to market failures. Such costs are a remediable market failure only if they are not minimized by the existing forms of economic organization. To the extent that the costs of government action are less than the value of the reduction in transaction costs, government intervention is called for on efficiency grounds.

- It is hard to see how rent regulation offers an efficient means to reduce transaction costs. In general, rent regulation will, on balance, increase transaction costs. To the extent that rent regulation facilitates the settlement of disputes between landlord and tenants, total transactions in the public sector, the costs to society as a whole are not necessarily reduced. But dispute settlement is only part of the transaction costs in rental housing markets and a reduction of the costs of disputes can be pursued independently of rent control.

2.5 Smoothing the Path of Adjustment (Chapter 4)

- Because rapid economic change can be costly, it is argued that temporary rent controls may be able to reduce the costs to society of adjusting to a new equilibrium in the rental housing market. For example, if it is believed that a period of excess demand will be short-lived, controls will prevent tenants and builders from over-reacting to sharply rising rents and expending resources to adjust to the disequilibrium situation.

- While the concept is appealing -- having people avoid unnecessary moving costs or building too much excess capacity -- it is flawed. It assumes, first of all, that government policy makers know what the new equilibrium level of rents will be and when it will be established. This is a strong assumption in the real world. Second, it assumes that government officials know more about the future than do households, landlords, and investors in rental property. If one accepts the rational expectations approach, this assumption is rejected. In general, therefore, it seems most unlikely that rent regulation could reduce the economic costs of adjustment.

2.6 Maintaining the Characteristics of Central Areas of Urban Cities

- It is argued that rent control is a useful policy in "freezing" the composition of the core of Toronto in terms of types of economic activity (commercial, industrial, residential), types of housing (ownership versus rental; apartments versus single family dwellings), and particularly the mix of residents by income level. By holding rents below the market clearing level, the rate of change in core areas of urban centres will be greatly slowed -- hence moderate and low-income households will continue to be able to afford to live near the centre of large cities.

- This argument stems from the "reform" policies of the early 1970s in Toronto as they relate to zoning and planning regulations. However, the maintaining balance and diversity argument was an *ex post facto* rationalization used by the advocates of rent control after controls had been in place for some years. The argument was not used in 1975 when controls were enacted in Ontario.

3.0 GENERAL PRINCIPLES AND PARTICULAR FACTS

In Chapter 1 I argued that we could learn a great deal about rent regulation by analyzing this particular species of regulation in the context of some of the insights that have been gleaned about government intervention generally and from the study of other forms of regulation. We also argued that the study of positive theories of government intervention could improve our understanding of the reasons why rent controls may be enacted. These theories were then applied to the case of rent controls in Ontario with a case study of the forces that brought about the initial legislation in 1975. See Stanbury and Thain (1985).

The reader will have to judge the power of the general analytical framework I have applied to a particular problem: rent controls in Ontario. The point I wish to make here concerns the respective roles of general principles (whether normative or positive), particular principles, and of particular facts. St. Thomas Aquinas reminds us that "when reason argues about particular cases, it needs not only universal but also particular principles". In making normative propositions about the role of government this argument has particular force. "Except for playful intellectual exercise, or as a first stage of a first approximation in a sustained logical argument, universal principles seem to ... have no useful role in argument and particular cases or restricted classes of cases to comprise almost everything that is worth arguing about -- or dying for" (Viner, 1960, p. 62). Therefore in thinking about the "proper" role of government, sweeping generalizations are unlikely to be helpful -- often because a set of general principles has built-in contradictions. Wisdom requires that we explore the conflicts between principles, search out the importance of degree, relation and proportion, and discover for particular values their appropriate relation to specific problems and opportunities (Viner, 1960, p. 63).

A fruitful analysis of rent regulation in a particular jurisdiction requires that very close attention be paid to the details in the design of that system and to the "nitty gritty" of how that system is implemented in practice. The impact of rent controls, perhaps more than other types of regulation, hinges on a deep understanding of a considerable number of details -- see Stanbury and Vertinsky (1985). However, knowledge of the details *without* an analytical framework or theory will produce little by way of understanding the consequences of the facts in one's possession. But it is equally true that the most rigorous and elegant theory of rent controls will have little predictive power unless it takes into account the details of the *specific* system of controls it seeks to understand.

The standard economic analysis of rent controls is derived largely from the general case of the imposition of price controls on a homogeneous commodity. The theory implicitly assumes that such controls are effective, that all transactors are well informed and that the control regime can be summarized in a single line. The problem is that discussions of a particular regime of rent regulation in place P at time T is conducted on the basis of assumptions that are frequently inappropriate. Conflict over the *effects* of controls (setting other issues aside) is sustained because different observers are operating on the basis of different assumptions. Because their assumptions are *implicit* rather than "laid out on the table", the debate generates much heat but little light.

If observer A is reasoning from the assumption that the control system consists of a complete and indefinite freeze on all rents during a period of considerable excess demand, it is no wonder his conclusions differ from observer B who is basing his conclusions on the following assumptions:[1] (i) rents are allowed to increase without review by about three-quarters of the increase in the CPI; (ii) landlords who can show increases in their costs above the statutory increase may obtain permission from the regulator to increase their rents sufficiently to recover their costs; (iii) a considerable fraction of the housing stock is exempt from controls; (iv) the regulator allows "permanent" increases in the legal rent sufficient to amortize capital expenditures for additions, maintenance, and repairs over a period shorter than their economic life and increases for subsequent replacements of the same capital item; (v) tenants have the benefits of standardized (statutory) security of tenure provisions; and (vi) landlords, except for short periods, are not forced to live with rent levels below their cash costs of operation. The problem is most intractable when the analyst fails to make his assumptions explicit.[3]

But even making the assumptions as explicit as we have done is unlikely to be sufficient to fully understand the likely effects of a particular system of rent regulation at a particular time. There are many intervening variables, of which implementation is one of the most important. As the first phase of the Commission of Inquiry into Residential Tenancies made clear, the words of the statute do not (and cannot) tell the whole story. Any regulatory agency exercises discretion and must interpret the statutory rules it has been given. Indeed, one of the hallmarks of most systems of regulation in Canada is the relatively high degree of discretion the legislature deliberately affords to regulatory agencies.[4] In a sense, "learning by doing" is assumed to take place. Further, it appears to be assumed that regulators will have to adapt the details of their regimes to the inevitable changes in circumstances as they occur in particular cases.

In the case of rent regulation in Ontario, the way controls actually work depends not only on the relevant statutes, but also very importantly on the forms, practices, guidelines, and interpretations of the Residential Tenancy Commission. The way controls work depends also on the behavioural response of the landlords and tenants subject to them — see Stanbury and Vertinsky (1985).

While economists' ideas about the likely response to economic incentives may have some predictive power in general, the response to a regulatory regime also involves peoples' attitude toward the law. Contrary to some economists, the individual's willingness to abide by the law is not solely a matter of weighing the discounted expected value of the personal benefits and costs of violating versus obeying the law.

To summarize: to understand the likely effects of a particular system of rent controls requires both an analytical framework or theory and a very healthy respect for the details of design and implementation that shape that system in practice. Conclusions about a particular system based on knowledge of general principles alone is almost certainly a recipe for poor-quality advice. Moreover, the optimal amount of government intervention is unavoidably a normative matter. Viner (1960, p. 63) notes that "Cournot, a distinguished nineteenth-century economist and philosopher, held that the limits of state intervention must be set piecemeal, by trial and error, in light of circumstances, of established customs, of ruling ideas, and cannot be dealt with as within the realm of scientific determination".

4.0 THE CONTENTIOUSNESS OF RENT CONTROL AS A POLICY ISSUE

4.1 General Perspectives

Rent control, as one observer put it, hits people right where they live. Perhaps that's why it is such an enormously contentious public policy issue.

We begin with the suggestion that the intensity of the conflict over rent controls may lie in the fact that the issues associated with rent control as a public policy are not held in common by the advocates and opponents of the policy. Rent control is not simply a case where both sides are dealing with the same issues but hold widely different opinions on those issues. In the case of rent control, what constitutes the relevant issues is hotly disputed. Those in favour of rent control deal with a set of issues that overlap very little with those being addressed by the opponents of controls. The Community Review and Research Group (1975, p. 22) of Toronto puts it this way. "Those arguments for rent control are largely derived from welfare and social justice concerns, those against are largely dire predictions of the consequences and complaints of inefficiency and injustice. The two sets of arguments are obviously based on different assumptions, one does not answer the other."

Second, the matter of rent controls may be highly contentious because the stakes are so large for so many people. As we have emphasized, the rent cheque is the largest single payment most renter households make every month and next to taxes the largest category of expenditure. Tenants account for 37% of all Canadian households and 45.4% of the households in the 23 Census Metropolitan areas. In Montreal, 58.3% of households are renters, while in Toronto, the fraction is 43.5% (CMHC, 1984, p. 86). The imposition (or ending) of stringent controls could cause the market value of rental buildings to change enormously. Landlords could see their equity wiped out or tripled by a sharp, unanticipated, change in public policy. There is evidence that some types of control regimes can, after a decade or two, result in a severe deterioration in the rental housing stock and virtually end new, unsubsidized construction in the controlled sector.

Third, rent controls lie between what Bartha (1982, p. 83) calls "universal" and "advocacy" issues. Universal issues "tend to affect large numbers of people in many walks of life [and their] exposure to the problem is either direct and personal or is made so realistic through an intermediary that people feel as if they had been directly exposed to it. The personal impact of such a problem is viewed as serious and imminent." Bartha (1982, p.83) continues, "it is a top-of-mind spontaneous source of concern for many people who believe that the problem is such that the government must deal with it and must find a relatively simple solution to it". Recall the close similarity of views of renters and homeowners regarding the fairness of rent controls and security of tenure provisions discussed in Chapters 2 and 3 above. However, it should be noted that "universal issues are not permanent -- they come and go chiefly as a result of social and economic conditions". Bartha defines advocacy issues as unlikely to emerge spontaneously in conversations with most people. "However, once the problem is identified and solutions are advocated by some groups in society, large numbers of people will react favourably to the idea of some kind of remedial action." He continues, "advocacy issues are usually introduced and promoted by groups claiming to represent broad public interests."

While the general reaction to universal issues is that "the government must act to solve the problem", the public's reaction to advocacy issues, says Bartha, is likely to be "somebody ought to do something about it". He suggests that with advocacy issues, "people are willing to take into account costs as well as benefits and acknowledge that certain trade-offs may be involved".

Fourth, rent control is a highly contentious policy issue because of contrasting perspectives and positions of landlords and tenants who must deal with each other face to face. The following observations have been made by people writing about landlord-tenant relationships:

- Landlords focus on the economics of ownership while the tenant focuses on the services provided, his security of tenure, and the amount of the rent he must pay to obtain a home.
- The tenant'x need for housing is immediate and continuous. In the case of low-income tenants, moving costs represent a capital outlay that is beyond their reach or one that would leave them indebted for some time. As a result, at least some tenants experience feelings of dependency and powerlessness vis-a-vis landlords in general. This feeling is exaggerated

in tight rental markets where landlords are able to replace tenants easily. Feelings of powerlessness breed resentment and the desire to increase the scope of individual autonomy.

- The financial resources of the landlord generally exceed those of the tenant. However, not all landlords are wealthy and not all tenants are poor. In the eyes of some, landlords are perceived to be economically self-interested "exploiters" of defenceless and poor, but deserving tenants. At the same time, the experience of some landlords suggests a fairly small minority of tenants can be irresponsible regarding their tenancy obligations. The central point here is the great diversity among both tenants and landlords in terms of their income, wealth, attitudes toward each other, intensity of economic motivation, and knowledge and use of the legislation concerning their relationship.
- The information resources (broadly defined to include knowledge of legal rights and mechanisms) of the landlord generally exceed those of the tenant. However, tenants did obtain considerable improvement in security of tenure prior to the imposition of controls in Ontario and particularly at the time controls were enacted in 1975.
- Each tenant has one landlord; most landlords have several tenants. In the short run, particularly when vacancy rates are low, tenants feel they have little choice while landlords can pick and choose their tenants. (It is interesting that virtually no one talks about the reverse situation, i.e., when vacancy rates are high and landlords are experiencing financial difficulties.)
- Tenants, by definition, live in the landlord's rental property; the owners of properties with more than a handful of units do not. Most people do not treat others' property with the same care and respect as they treat their own.

- The landlord-tenant relationship is made more difficult because what both parties are to receive in the exchange is not fully specified, e.g., level of maintenance/repair, damage by tenants, number of occupants, and certainty of payment.
- Where the terms of the tenancy are not specified in a lease, the landlord usually has more discretion in defining the terms of the arrangement than does the tenant. However, with the advent of new landlord and tenant legislation many of the terms of the tenancy agreement are specified by statute.
- Where a landlord owns many properties or a single large property, he seldom deals face to face with tenants. Rather, tenants deal with his representative (e.g., employee) in a relationship that varies from hostile to warm and personal. But behind this relationship is the fact that the landlord or his representative has a greater capability of invading the privacy (personal space) of the tenant than the tenant has of the landlord.

I have noted how those for and against rent controls conflict over the same values and advocate different values. In some ways, the battle over rent controls is a symbol of deeper differences about how people see the world in general terms. At the risk of caricaturing both the advocates of rent control and its opponents, I have prepared Figure 5-1. In it I try to get inside the persons on each side of the issue. Several points should be emphasized. First, it is a large step from an individual's "world view" to his position on a specific issue such as rent control. The statements in Figure 5-1, however are consistent with the views of persons who are strong advocates or opponents of rent control. Second, I have had to make generalizations and these can easily be wrong for any individual. Third, the picture I have drawn of advocates' and opponents' weltanschauung itself is incomplete. I have listed only those elements that appear to relate to a person's position on rent control. Fourth,

Figure 5-1

Weltanschauung of Advocates and Opponents of Rent Controls

Advocates	Opponents
• Tend to be concerned with "basic human needs, particularly for the economically disadvantaged.	• Often believe that efficient markets are the best way to meet the needs of individuals.
• Often willing to intervene directly in markets that are deemed to be performing poorly -- not achieving the desired distributional outcomes.	• Usually less willing to intervene directly in market processes in order to redistribute income.
• Tend to focus on people, not property or the rights of property owners. Many believe landlords should bear the burden of helping poor or vulnerable tenants.	• Concerned with property rights in general. Believe that if society wants redistribution, all taxpayers should share the burden.
• Generally a strong belief in the efficacy of government intervention. Tend to stress non-economic motivations.	• Often more skeptical that government actions achieve their ostensible objectives. Tend to stress individuals' response to economic incentives.
• Often prefers allocation by a political or administrative decision making process to the cash nexus of the market.	• Tends to distrust political or administrative decisions that allocate goods and services directly. Willing, in many cases, to have government make cash transfers and let beneficiaries choose how to allocate their increased income.
• Tend to take a shorter term view -- see a pressing need to act quickly. May ignore or consider longer-term consequences that are diffused to be less important.	• Often takes a longer, more systemic view (which is not inconsistent with their short-term immediate interest).
• Concept of justice is based on perceptions of shared values of "fairness" -- regardless of consequences for market processes. Tend to have more of a "sharing ethic" based on meeting "basic human needs".	• Concept of justice is tied up in the idea of individual autonomy, ability to function well in market exchange, rights of private property, and willingness to take risks.
• Often more concerned with collective rights than individual rights. Believe that governments have a major role in providing or guaranteeing collective rights.	• Tends to focus on rights and responsibilities of individuals; less concerned with social rights.

I am painting a collective rather than an individual portrait. While parts of the picture may be a close reflection of any individual's reasoning for or against rent controls, other aspects will not be a true likeness. Finally, we have not been able to distinguish among the many possible systems of controls -- except to the extent that we are assuming (as do the strongest advocates and opponents of controls) that controls effectively keep rents in the controlled sector below what they would have been in their absence. Different systems of controls may alter the position of individuals.

4.2 The Particular Sensitivity of Rent Payments as an Economic Variable

No discussion of the normative bases of rent regulation would be complete without an analysis of the reasons that monthly rents appear to be more sensitive than other economic variables.

4.2.1 Largest Single Expenditure: The rent cheque is the largest single expenditure the typical household makes each month over the long term. While taxes of all types collected by three levels of government together as a category of expenditure are likely to absorb a larger fraction of the household's annual income, they are, with the exception of the personal income tax and retail sales taxes, largely hidden. How many citizens appreciate that a bottle of liquor for which they pay $10.00 consists of more than $8.00 in federal and provincial taxes and markups? How many appreciate that in Ontario 58% of the pump price of gasoline of 47.1 cents per litre consists of federal and provincial taxes (Pipes & Walker, 1984, pp. 12, 11)? In 1961 Pipes & Walker (1984, p. 54) estimated that the average Canadian family paid 22.1% of their total income before tax in taxes of all types while shelter (including home owners and renters) accounted for 12.9%, food for 16.1%, and clothing for 5.7% of total income. In 1983 the comparable figures for the average family were taxes, 33.2%; shelter, 10.7%; food, 8.9%; and clothing, 3.6%. However, for lower income families, the shelter component is larger, although those in the lowest three income deciles in 1981 paid 13.6%, 19.5% and 24.4% of their before tax income in taxes of all types (Pipes & Walker, 1984, p. 66).

4.2.2 Pattern of Increases: The pattern of increases in a family's rent is quite different than it is for its other major outlays such as food, taxes, and transportation. Rents are usually increased only once per year. (This was true even before controls were imposed.< Food prices change much more frequently, particularly those for fresh fruit, vegetables, and meat. Because it comes in one single step each year, an increase in rent is also the largest absolute increase in prices a household faces. When the rent cheque is now $550 rather than $500 the increment is noticeable -- even if one's gross income rose by 12% over the previous year. Even today, $50 per month is a sum to be reckoned with.

4.23 Difficulties in Adjusting Housing Services: When food, clothing, and transportation prices (excluding local transit fares) rise, an individual or a family can make marginal adjustments to find the "best" relationship between its income and changing relative prices. If red meat goes up, one can obtain a similar amount of protein from fish, eggs, or cheese, by substituting cheaper cuts, or by buying chicken. If a head of lettuce jumps in one week during the winter from 59 cents to $1.19, one can skip lettuce for a week or two and concentrate on cucumbers and tomatoes or cabbage. Comparable adjustments cannot be made easily in the case of rented accomodation. If the rent rises by 10% one cannot reduce the amount of floor space in one's unit by 10% in an effort to try to keep the monthly outlay for rent unchanged. There are substantial short-run indivisibilities in determining the amount of rental housing services one consumes.

Knetsch et al. (1984, p. 2) note that "the rental housing market...may offer the buyer neither as much opportunity to choose nor as much ease of adjustment. Although many different prices and forms of rental accommodation are offered in most communities, the range is sometimes limited and landlords may be unwilling to rent to some groups of tenants such as families with children. Consequently, the possibilities for substitution are far more limited than for most other goods."

Longer-run adjustments to steadily rising rents may require a family to move to a unit that is smaller and/or of lower quality. Or the family may have to live farther from its place of work and spend more time commuting. Moving usually involves substantial transaction costs and these are usually far more than the cheque to the moving company. There are the emotional costs and the loss of improvements to the existing unit that cannot be moved, e.g., painting, garden improvements, structural changes to suit one's preferences. (It should be emphasized that when a tenant moves, the landlord also has to incur transaction costs, e.g., he has to clean the unit, advertise, and he will forgo rent if the unit goes vacant.)

4.2.4 Identifiability of the "Source" of Increases: Rent increases are made by an identifiable individual -- the landlord -- even if the building is owned by a corporation. Increases are not perceived as exogenous and impersonal. Contrast this situation to a rise in food prices, which in 1975 rose by more than the increase in the rent component of the CPI. First, as we have noted, food prices don't all rise together once per year. They move up item by item every few weeks or several times per year. Moreover, the absolute increase on a specific item is small. A food price increase means that the 32 ounce jar of strawberry jam now costs $2.49 when the last jar of the same brand cost $2.19.

Second, except for a few staples purchased every week, consumers find it hard to "track" increases in food prices for themselves, although the CPI figures are frequently in the news. In contrast, it is very easy to recall that the rent was $440 per month last year and this year it is $500, an increase of 14%.

Third, when food prices rise, a complaint to the supermarket manager often results in him telling you that he is not the source of the problem. Rather, the price he pays for the item went up, so he is just passing along the increase. He may even be able to show that the increase in the shelf price is less than his increase in what he pays his supplier. How many people can trace back through all the linkages to find the "real culprit"?[5] In any event, in the absence of controls, the linkage between costs and "prices" will generally be much looser in the case of rental accommodation than it is between costs and prices in other areas of the economy where the elasticity of supply is much greater than it is in rental accommodations.

Fourth, from the point of view of the household in the short run there is only one supplier of rental accommodation -- its present landlord. When food prices rise, the family can turn to quite a number of alternative suppliers very easily. Moreover, the daily newspaper each week provides plenty of free information as to what the major supermarkets are charging for a variety of food items. One can easily opt for a better deal with one's feet and this week's food budget. Even though all the major chains may increase their prices for a group of items by almost the same amount over the course of a few days or weeks, the consumer has a choice. He can switch to signal his displeasure.[6]

4.2.5 Intangible Services: Rent is paid for an intangible -- a flow of housing services. Although the "plant" that produces these services embodies a large amount of physical capital, what a building produces is space, warmth, a location, and perhaps a view. Many people feel that paying rent for years "produces nothing". The refrain goes, "you pay the rent every month for 20 years but at the end of it there is nothing to show for it". This argument has great appeal. Some 63% of Canadian households in 1982 owned their own home and 29% of those that do don't have a mortgage. After 20 or even 30 years of monthly mortgage payments, it is eventually owned free and clear. In the same vein, after three or four years of payments on a car, one owns a clearly identifiable, tangible thing even if the rust is showing and the engine needs an overhaul.

Hence, for some, rent increases add insult to injury. The price of "nothing" goes up! These feelings are exacerbated if the tenant also believes that the landlord personally produces nothing, but is only engaged in a pecuniary, paper-shuffling exercise. He takes in the rent, pays the mortgage and keeps the balance for "just sitting around". People in factories make things: cars, clothing, processed food, or appliances. The fact that almost one-half of the GNP now consists of services is of no consolation to the tenants who believe that their rent buys them "nothing" from an "unproductive" landlord.

4.2.6 Threat to Security: Having a roof over one's head is usually deemed to be a critical element in determining an individual's sense of security and emotional well being. Large rent increases, particularly if one's income has not grown proportionately, can easily be perceived as a direct threat to a family's stability and security. There is almost no more pitiable sight than a family standing beside its belongings piled on the side of a street with nowhere to go. In a Canadian winter, there is no option of sleeping under the stars in a park even for one night. Moreover, the lack of shelter is the most obvious and public sign of one's poverty and helplessness.

Obviously, every rent increase, even for people of moderate incomes, is not a crisis. But psychologically, a sudden, large increase in rent or a recent pattern of steady increases can threaten a family's sense of security. These threats may be wholly disproportionate to the size of the increase, and such threats may be much more severe than would occur in response to increases of the same percentage for other items. One has only to think of the increase in energy and food prices relative to those for rental housing in Canada between 1973 and 1982 -- see Table 6-1.

Table 6-1

Annual Percentage Increases in Prices in Four Basic Expenditure Categories

	Energy	Food	Housing	Rent*
1973	9.0%	14.6%	6.5%	1.4%
1974	15.2	16.3	8.7	2.7
1975	13.5	12.9	10.0	5.4
1976	15.4	2.7	11.1	7.0
1977	12.2	8.3	9.4	6.3
1978	9.3	15.5	7.5	5.3
1979	9.8	13.2	7.0	4.4
1980	16.0	10.7	8.2	4.8
1981	30.1	11.4	12.4	6.4
1982	19.8	7.2	12.5	9.0
total increase	267%	153%	129%	64%

* Canada-wide rent index of constant quality units.

Source: Dept. of Finance Economic Review, April 1983 (Ottawa: Minister of Supply and Services, 1983); and Statistics Canada, Cat. No. 62-010 and 62-001.

4.2.7 Egalitarianism and the Economic Position of Tenants: Canadians have both a strong egalitarian streak and a strong desire for economic security. These values are reflected in the elaborate and costly income security programs ranging from unemployment insurance to old age pensions to the transfers in kind embodied in medicare. The call for government actions to assist tenants is perfectly consistent with Canada's "redistributive ethic" (Hardin, 1974) when it is appreciated that a considerable number of tenants have moderate to low incomes.

It is also widely recognized that tenants have lower incomes than do homeowners. The dream of home-ownership is undiminished and its strength is shown by the degree of frustration felt by many when the high and persistent inflation of the 1970s put home-ownership beyond their reach.[7] Tenants, in a sense, came to be seen as "underdogs". As such, many Canadians feel they deserve extra consideration from public policy when they face sharply rising rents.

In 1982, 36.7% of Canada's 8.4 million households lived in rented accommodation, as compared with 37.3% in 1967. Their median income in 1981 was $18,000 as compared with $29,000 for households owning their home. While the overall ratio of home-ownership changed little between 1967 and 1981, the position of households in the lowest quintile of income deteriorated noticeably. In 1967 62.0% owned their own house, but this dropped to 43% in 1981. Households in the second quintile experienced a slight decline in home-ownership, from 55.5% in 1967 to 52.4% in 1981. In contrast, the fraction of home-owning households in the top two quintiles of income increased by over 10 percentage points over the same period. For the fourth quintile the figures were 64.2% to 75.0% while for the top quintile of households, it was from 73.4% to 83.5%.[8]

Table 6-2

Identifying Renter Households in Canada, 1982

Category of Household	% of Tenants in the Category	Category as % of all Households	Median Income of Tenant Households
° Single parent with children under 18	60.6%	4.7%	$ 9,635
° 1 person, under age 65	73.4	12.8	13,994
° 1 person, over age 65	53.0	6.9	6,949
° in urban areas under 30,000 pop.	73.4	15.2	13,994
° all households	36.7	100.0	11,054

Source: Statistics Canada, Household Facilities by Income and Other Characteristics (Ottawa: Minister of Supply and Services, 1983) Cat. No. 13-567.

Tenant households are concentrated in urban areas. For example, 44.6% of the 59% of households live in cities of more than 100,000 population. In contrast, only 12.9% of households in rural areas, which account for 17.4% of all households, are tenants. While only slightly more than one-quarter of the 76% of single family households (with or without children) were tenants in 1982, 60.6% of households consisting of single parents with children under 18 are compared with $20,700 for couples with children under 18 who are also tenants and $31,900 for such households who are owners.

Table 6-2 identifies the types of households that have a much higher probability of being tenants. Almost three-quarters of single-person households under age 65 are renters, while 53% of such households over 65 are tenants. However, the latter group have a median income only one-half the former.

5.0 FROM NORMS TO POLICY CONSIDERATIONS

Chapters 2, 3 and 4 have examined five normative bases for rent regulation as a form of government intervention. The arguments were grouped into three categories, namely that some form of rent control is desirable in order to alter the distribution of income, to create rights, or to improve allocative efficiency. We now face the inherently delicate task of moving from the analysis of normative arguments to policy considerations.

I proceed as follows. First, I elucidate the argument that the existence of some form of market failure -- even if it is broadly defined to include distributional considerations -- is a necessary but not sufficient condition for recommending that the government act to try to ameliorate the problem identified. Second, I discuss the need to make trade-offs among the various normative objectives and what advice an "expert" can and cannot give in that context. Third, I review the relationship between economic efficiency and society's welfare with particular reference to the role of income distribution.

5.1 From Market Failure or "Distributional Failure" to Policy Action

It should be emphasized that the existence of a true market failure is not a sufficient condition for government intervention. As Wolf (1979, p. 107) points out, "policy formulation properly requires that the realized inadequacies of market outcomes be compared with the potential inadequacies of non-market efforts to ameliorate them". This point may be generalized to "distributional failures" as well, i.e., where there is a widely held view that the distribution of income, wealth, or consumption opportunities produced by market forces is not socially (ethically) optimal. The public policy remedies for market failure or "distributional failure" may themselves fail for reasons similar to those underlying market failures because of the nature and structure of incentives facing actors in the government. Outcomes may diverge from those held to be socially preferable or optimal.

Wolf (1979, pp. 116-131) identifies and describes four types of non-market or government policy failures. First, there are "internalities" and private goals that come into existence in government agencies because of the absence of direct performance indicators such as prices and profits that exist in economic markets. Because of the lack of exogenous performance measures, public agencies must develop their own standards and reward systems to coordinate behaviour to accomplish their official objectives. These internal or private goals or standards may persistently diverge from the unit's official goals -- often because the latter are hard to define in operational terms. Wolf (1979, pp. 119-123) identifies and describes several specific internalities: budget growth -- "more is better"; technological advance — "new and complex is better"; and information acquisition and control -- "knowing what others don't know is better".

Second, public agencies tend to exhibit both X-inefficiency (redundant costs) and rising costs over time in real terms. Wolf (1979, p. 124) notes, "with rewards frequently accruing in the political arena to publicizing the problems and initiating action labelled as a remedy, nonmarket activities may be authorized which have quite infeasible objectives." The problem is exacerbated when voters and politicians fail to identify the real cause of various "failures", e.g., when a previous government action rather than a true market failure is the culprit. Costs rise in real terms because of both the difficulty in measuring the value of output and because of weak feedback mechanisms when real costs exceed real benefits, i.e., when there is little or no penalty for losses.

Third, "government intervention to correct market failure may generate unanticipated side effects, often in areas remote from that in which the public policy was intended to operate" (Wolf, 1979 , p. 126). In the political arena demands for immediate action are high and time perspectives are short. Action may be taken before a proper diagnosis is made and alternatives may be chosen before all of their consequences are appreciated. Moreover, the sheer size of government increases the likelihood of its creating "derived externalities".

Finally, government action to overcome perceived distributional inequities of market processes (and the distribution of original endowments), may themselves generate distributional inequities. The modes of redress, as Wolf (1979, p. 128) points out, inevitably "place authority in the hands of some to be exercised over others". The discretion necessary for the public decision-maker to "do good" can also provide opportunities for misdirection, abuse and inequity. One has only to think of the vagaries, perversities and inequities in the operation of virtually any transfer or subsidy program. Moreover, while many economists have trouble with the concept of power, power does exist and can be used to "redirect" otherwise laudable public programs to benefit the few at the expense of the many. See the discussion "regulatory capture" in Stanbury and Thain (1984). Wolf (1979, p. 130) points out that "on the supply side, distributional inequities [of government intervention] result from the typical monopoly of nonmarket output in a particular field and the related absence of a reliable feedback process to monitor agency performance". The "losers" either don't know or can't organize to prevent the inequity while the "winners" have exactly the opposite characteristics.

In summary, government intervention is not a "free lunch". It has real costs, although these may not be obvious and may be delayed in their appearance. The policy analyst (or adviser) must ask in the face of clear evidence of market or "distributional failure" -- is the game worth the candle? One cannot assume that government action will necessarily remedy the market or distributional failure, or that the costs of doing so are less than the benefits.

6.2 The Problem of Trade-offs

Virtually all new public policies or changes in existing policies require trade-offs to be made. They are often not acknowledged, precisely because it is painful to do so. The evidence of trade-offs embodied in specific choices (and a policy always consists of a host of choices) provides a "map" of what and who the policy-maker thinks is important. The essence of a trade-off is the necessity of giving up something to get something else. If we want more of desired objective A, we must accept less of desired objective B. Therefore, in opting for more of A we can say that the cost of another increment of A is the amount of B forgone. This is a perfect illustration of the idea of costs as opportunity costs; i.e., costs are benefits lost -- that which must be given up to get something else. As the theologians remind us, the hardest choices are not between good and evil, but between two goods. So it is with a public policy like rent control.

The arguments for rent regulation, as we have seen, embody three types of norms:

(i) improving the efficiency with which resources are allocated by

- eliminating market failures present in rental housing markets such as imperfect information and high transaction costs, and
- stabilizing the path of adjustment during disequilibrium conditions.

(ii) altering the distribution of income, wealth or consumption opportunities by

- preventing rent "gouging" or "unconscionable" increases in rent,
- increasing (maintaining) the affordability of the existing stock of rental units, or
- maintaining the economic, social, and physical structure of central urban areas.

(iii) creating rights by

- ensuring that tenants have security of tenure.

Three types of trade-offs can be identified: (i) trade-offs among normative objectives, e.g., between allocative efficiency and "equity"; (ii) among groups, i.e., who will gain or lose from particular actions; and (iii) trade-offs between different periods of time. The second type of trade-off is a concomitant of the first; i.e., those "winners" if we favour efficiency over equity are almost certainly different than the "winners" if equity is given greater weight.

I now discuss "first order" trade-offs. Efforts to use rent control to alter the distribution of income (or to prevent a change in the distribution of income) can have an adverse effect upon allocative efficiency depending upon the nature of the control regime. The use of rent controls to alter the distribution of income can result in significant effects on wealth because the expected stream of lower future rents is capitalized into the value of the property. Establishing a strong form of security of tenure as a legal right for tenants will affect both the distribution of income and wealth and reduce allocative efficiency.

I would suggest that efficiency as a normative objective appears to have a much lower priority in the hierarchy of objectives of the proponents of rent control than do distributional and rights considerations.

I now discuss "second order" trade-offs. Rent controls imposed to prevent rent "gouging" will prevent a redistribution of income from existing tenants to existing landlords provided the controlled rent exceeds the landlord's costs, including a normal return on capital. If the sharp increase in rents is due to similar increases in costs, then controls may result in redistribution from existing landlords to existing tenants. In either case, new tenants, for example, those from outside the jurisdiction, will face higher search costs for a controlled unit, or will pay much higher rents in the uncontrolled market or will be forced into ownership costs above what they would pay in the absence of controls. Note that rents in the uncontrolled sector (for equivalent units) will be above what they would have been in the absence of controls in the short run, but not necessarily in the long run.[9] Therefore, new entrant tenants are "losers" and owners of existing but exempt buildings (e.g., "luxury market") are "winners" in the redistribution of income attendant on rent controls.

Rent controls, in order to provide security of tenure, may impose costs on landlords that are greater than the benefits received by existing tenants; i.e., we may have a negative-sum game. In the long run, tenants as a whole will pay the costs of improved security of tenure. But not all tenants want the same degree of security of tenure and they will be unable to "unbundle" the premium for security of tenure from the rent alone. There will be redistribution among existing tenants.

Gains from improving allocative efficiency will tend to be widely distributed. They will accrue to existing and new tenants and to existing and new landlords. It will be all but impossible for individuals to appropriate such benefits —! unlike the case of existing tenants when rent controls are imposed.

The "third order" trade-off involves the implicit rate of exchange between the present and the future. Once we date the benefits and costs of rent control their attractiveness becomes more explicable. Suppose a draconian freeze is placed on all rents and it is expected to last indefinitely. The largest distributional effects are evident immediately. The owners of existing buildings suffer a large capital loss instantaneously. Existing tenants get their benefits -- lower rent -- in the form of a monthly annuity, unless they can sell their occupancy rights to someone else. The monthly benefits will rise over time if the increase in the market-clearing rent exceeds the increase in the controlled rent. (They can keep the benefit only by staying in place or by finding another controlled unit.)

The efficiency costs of the freeze, however, appear more slowly and less obviously. For those that ignore opportunity costs but count only cash outlays, these costs may appear to be small (see Knetsch et al., 1984). The size of the efficiency cost in terms of the impact of controls on new construction depends critically upon the regulations that define a particular control regime. For example, if controls cover new as well as existing buildings and it is expected that the increase in the controlled rent will be below the increase in the market-clearing rent, then new construction will likely "dry up" (except for government-subsidized buildings). New construction of rental accommodation at the controlled rents will not allow the investor a normal return. Who bears this cost? Not those who were tenants the day controls went into effect. It is future tenants (and potential tenants) who search long and hard for a rent-controlled apartment or who pay large sums as "key money" to existing tenants or landlords. More generally, see Stanbury and Vertinsky (1985).

However, if new construction is exempt from rent controls it may be little affected. On the other hand, if investors believe that in the near future controls will be extended to cover new buildings, the rate of new construction may decline very substantially. The threat or perceived threat of extension of controls greatly increases the risk of investing in new rental buildings; therefore the number supplied will decline, all other things being equal.

The other efficiency cost that is slow to appear is the possible decline in maintenance that may follow from rent controls. Here, too, the impact depends very much on the details of the regulations affecting maintenance expenditures. Suppose controls are based on a fixed increase per year with no exceptions and no pass-through of capital expenditures for maintenance and repair. Suppose also that the landlord's costs are rising faster than controlled rents. Then, because rents don't keep up with costs, landlords seek to redefine the terms of the contract by reducing maintenance expenditures and thereby the quality of the unit. These costs are borne by existing tenants (and by future tenants if maintenance declines after the new tenant moves in). Therefore, these costs, as well as the transaction costs of trying to enforce the original maintenance standards in court, must be deducted from the monthly saving in the rent.

However, if landlords can obtain rent increases that reflect their increased operating and maintenance costs on a "cost pass through" basis it is unlikely that maintenance expenditures will decline. Moreover, if capital items for major repairs (e.g., a new roof) can be built into the rent base permanently each time they are made, the landlord's rate of return on these incremental expenditures may be far higher than his average rate of return. Therefore, he will have a strong incentive to upgrade his building, thereby increasng his rents and his average rate of return. As I emphasized in section 3, the likely effects of rent control depend upon the details of the system of controls.

When controls are imposed, modified and removed or when political debate rages about the prospects for controls, the long-term consequence is likely to raise the perceived risks to owning rental property. While windfall gains may be made when controls expire, windfall losses will be incurred when they are imposed or the market believes they will be imposed. Increased volatility in the rental housing market will result in a higher required rate of return being demanded by present and future property owners. In other words, the discount rate applied to net income streams from rental properties will rise. All other things being equal, market rents will rise to reflect the higher cost of capital. With the extension and tightening of controls in 1986, the worst fears of landlords came true.

However, as Keynes has reminded us, in the long run we are all dead. One does not have to apply this dictum to appreciate why adverse effects of a policy that appear only in a few years are deemed to be irrelevant. If people discount the future at 20% a year, then a certain loss of $100 that occurs five years from now is equivalent to $40.19 today.[10]

5.3 "Experts", Citizens, and Trade-Offs

While the "expert" analyst can help to identify the normative arguments, define them and analyze their internal structure, he cannot offer "expert" advice on the importance of one norm versus another. When it comes to deciding on the weights to be assigned to different objectives in the hard task of making trade-offs in a democracy, the expert is only a citizen. His or her preferences ought to be given no more or less weight than any other citizen.

There *is* a role for the "expert", however, in helping citizens and political institutions to cope with policy decisions that inevitably require that trade-offs be made among a number of objectives. The propositions that follow are predicated on the assumption that it is better that hard choices be made on a well-informed basis.

First, the "expert" can make citizens and political leaders aware that trade-offs are necessary. Trade-offs cannot be avoided even if they are not made explicit. The costs of some actions may be hidden, may take the form of opportunity costs, and may not occur immediately. The fact is that feasible policy actions usually cannot achieve all of the goals specified for them. In the case of rent controls we may well be able to alter the distribution of income that would occur if the market was left alone, but it is virtually inevitable that we will reduce efficiency in the allocation of rental housing. Such a trade-off may be widely preferred, but before we "buy" the policy we ought to know its price tag. What are we giving up to get what we want?

Second, the analyst may be able to identify the "rate of exchange" between various policy objectives. He may be able to determine, for example, how much impact a particular system of rent controls is likely to have on the rent-to-income ratio of low-income families, and what the cost of achieving this result is in terms of other objectives, for example, efficiency. Similarly, the analyst may be able to provide a rough estimate of the consequences of implementing a particular body of security of tenure legislation in terms of the foregone benefits of other objectives. It should be emphasized that this is a most difficult task. The estimates will be approximations. But it is better to be roughly correct than absolutely wrong or to ignore a potential effect altogether.

Third, the analyst may be able to disentangle the incidence of the costs and benefits of particular policies among identifiable groups. Presumably we want to know who the "winners" and "losers" are, as well as the nature and size of the total benefits and costs of a policy action. It is sometimes argued that if such information is made widely available, the result will be an increase in political conflict. But there is a danger too that we are merely "papering over" our conflicts of interest in the name of preserving the status quo. The question remains: how can individuals judge the desirability of particular public policies if they don't know their distributional implications?

Fourth, the analyst can make it clear that the most difficult trade-offs involve incommensurables. Indeed, most value trade-offs involve desiderata with non-comparable units. While efficiency costs and distributional benefits can be measured in dollars, one cannot measure an increase in a tenant's security of tenure in such terms. It may even be impossible to judge the relative strength of alternative sets of security of tenure provisions except by rank ordering them; i.e., individuals may only be able to say that set A is preferred to set C and set C is preferred to set B.

Even where the unit of measurement is the same, we can't escape the problem of incommensurability except by having each individual rank order alternatives. For example, each person will have to decide if they prefer policy 1 to policy 2 where policy 1 will effectively reduce the rent of 10,000 low-income families by $100 a month at the expense of landlords together with an efficiency cost of $15 million per year. Policy 2, on the other hand, will reduce the rent of 5000 low-income households and 15,000 moderate income households by $50 a month at the expense of landlords, together with an efficiency cost of $20 million per year. How does one choose between these alternatives? Note that even if we are able to measure accurately the impact of a proposed policy, this does not make the choice easier.

Even after each individual ranks each policy alternative, we have the enormous problem of "adding up" each person's preferences. In doing so we cannot avoid some value judgment about the weights to be assigned to each person's preferences. Should the interests of the least advantaged group in society be given greater weight than those with high incomes as Rawls (1971) suggests?

Fifth, the analyst can remind the policy makers that individuals' preferences regarding the normative bases of particular policies are not highly stable. March (1978, p. 598) argues that

> human beings have unstable, inconsistent, incompletely evoked, and imprecise goals at least in part because human abilities limit preference orderliness. If it were possible to be different at reasonable cost, we probably would want to be.

Without being an economic determinist, one can observe that general economic conditions and the individual's own economic circumstances do alter the weights assigned to different objectives. Policies "cast in stone" may, within a year or two, be badly out of kilter with the public's preferences. Individual wants which are transformed by the political process into legally enforceable rights may effectively be accorded a higher weight in the future when changes in preferences would otherwise shift the trade-offs among norms -- see Stanbury (1985, Ch. 4).

Sixth, most people have difficulty in choosing among normative ends independently of the means to achieve them. Ends and means are interdependent. In fact, many people think in terms of specific policies and find it easier to choose among them than among desirable objectives in the abstract. Policy proposals are complex bundles that embody some notion of the problem that motivates the demand for action, the ends to be achieved, and the means to achieve those ends.

In making trade-offs, therefore, policy makers need to be aware that means are also important. For example, rent controls, to the extent they keep rents in the controlled sector below the market-clearing level, provide an apparent gain to existing tenants in kind. Such "transfers" do not have the stigma of being labelled as "government handouts". If rent control can be construed as a natural part of the right to security of tenure, then whatever (some) tenants gain is simply attributable to the exercise of their rights. The tenor of argument is thereby changed significantly.

5.4 Economic Efficiency, Pareto Optimality, and Society's Welfare

There are some things we cannot say about the desirability of competitive markets, the role of allocative efficiency, and society's welfare. We cannot say that competitive markets will produce results that maximize society's welfare. We can say that universal, perfectly competitive markets, in the absence of market failures, will produce a Pareto optimum. But Pareto optimality refers only to the efficiency with which resources are allocated. It does not tell us if maximum allocative efficiency is optimal in terms of society's welfare. In terms of the Pareto criterion, we know that market failures do impair the functioning of a competitive market and will make the allocation of resources less efficient. A Pareto optimal position is one in which it is not possible, by rearranging inputs or outputs, to make at least one person better off (in his own judgment) without making at least one other person worse off. But there is a Pareto optimum for each set of original endowments and for each distribution of those endowments.

A social welfare optimum requires that we combine our interests in allocative efficiency with our concerns about the distribution of income. The Pareto criterion is itself an ethical postulate that rules out interpersonal comparisons of utility (satisfaction) but is used to compare alternative allocations of scarce resources. A practicable concept of society's welfare requires that we undertake some sort of interpersonal comparisons of utility or satisfaction as we weight the importance of different individuals' preferences in moving from individual orderings to collective orderings. In addition, it is obvious that individuals have strong feelings about who ought to get what, i.e., the distribution of income, wealth, and consumption opportunities.

The central point is that decisions designed to maximize society's welfare collective must take into account both allocative efficiency and the distribution of income, wealth, and consumption opportunities. Society's welfare might well be maximized by a set of arrangements (market activities and government intervention) that is less than Pareto optimal in terms of allocative efficiency but has a distribution of income that is greatly preferred. But efficiency in terms of the Pareto criterion is not independent of distributive outcomes. It may be that "too much" egalitarianism will affect incentives to engage in activities that increase output and move society to a Pareto-preferred position. But it is foolish to ignore the fact that for most individuals their utility function (sense of satisfaction with life) includes more than market-produced goods and services they are able to own and consume personally. People care about the welfare of others, although these feelings of interdependence tend to decline quite sharply beyond the ambit of one's immediate family, relatives and friends. People also care about the way in which some things are allocated. As I have emphasized in the discussion of rights created by government in Stanbury (1985, Ch.4), it is held that some things should not be allocated by market processes. Certain political rights are allocated by collective decision on a universal and equal basis. They may not be traded.

Obviously, ideas of what combination of goods and services, rights, and distributional outcomes that make for a "good society" vary widely across individuals. Finding the combination that is an acceptable compromise is difficult, and the consensus is often fragile. Markets represent an enormously useful tool for allocating resources efficiently. Moreover, they are capable of functioning quite effectively in the face of numerous constraints. Their utility is not obviated by the fact that some production processes require large amounts of capital, that production facilities need to be fixed in location for long periods, that capital is durable, and that goods and services are variegated rather than homogenous.

But markets and market processes cannot do everything to achieve a "good society". Other institutions and processes must be used, and some constraints placed on the realm of free exchange even if there are gains from trade. There is a danger, however, in our desire to achieve certain distributive outcomes that we will too quickly -- through government action -- seek to alter the "internal" workings of market processes in order to ensure that "who gets what" will more closely conform with our preferences for distributional outcomes. The problem that this approach entails is not that allocative efficiency will almost certainly be reduced. (In some cases as we have noted in Volume 2, Chapter 2, government action can improve allocative efficiency by remedying some market failures.) The problem is that the opportunity cost of getting the desired distributional outcome -- for example, to improve the position of the vulnerable or those with low incomes -- will be hidden from most citizens. In fact, the positive theory of public choice suggests that it is precisely for this reason that interest groups and politicians combine to effect distributive changes by modifying market processes directly than by raising taxes and transfers to alter who gets what. In other words, if the market were left alone (except in the case of true market failures) to allocate resources as efficiently as possible and redistribution were done by means of direct cash transfers to the individuals deemed to be deserving of help, the costs and the identify of the beneficiaries of such redistribution would be more readily apparent to the average voter. Such "transparency", it is argued, will probably reduce or eliminate many actions by government to redistribute income and/or wealth where it is clear that those already well off are using the coercive power of government for essentially private purposes. This is the core of many of the positive theories of government action discussed in Stanbury and Thain (1985), and Hartle (1984).

The argument, therefore, is not to view unfettered markets as ordained by holy writ. Nor is it to endorse the status quo. The argument is to consider carefully the costs and benefits, broadly defined, of government action to alter market processes -- and to consider carefully to whom those benefits and costs accrue. If such information is "on the table" -- albeit in the form of admittedly rough estimates -- the hard choices facing policy makers will be clearer. As imperfect as it is, the political process in which these choices are made can hardly be made worse by this type of reasoning and the information it seeks to provide.

Notes to Chapter 6

1. In a war the government wants to reduce private consumption so as to make a larger fraction of society's resources avilable for the war effort. Therefore, the government does not want higher rents to act as a signal to the private sector to increase the stock of housing.

2. Exogenous constraints are those limitations on the policy-maker's actions that are beyond his control. They are, in effect, givens that he must work with as they are, not as he would like them to be.

3. See, for example, the discussion in Goldberg (1983, pp. 67-68) in his "primer on housing markets, policies and problems". It should be emphasized that we are not "picking on" Goldberg, but using his admittedly brief analysis to show that even sophisticated housing analysts do not always state their assumptions clearly and use simple micro-economic analysis to derive general conclusions that can be misleading in a particular case. A more general analysis can be found in Stanbury and Vertinsky (1985).

4. See, for example, Janisch (1979) and the studies of particular regulatory agencies supported by the Law Reform Commission of Canada, e.g., Lucas and Bell (1977), Janisch (1978), Johnston (1980), Doern (1977), Kelleher (1980), Slatter (1982), Vandervort (1979), and Law Reform Commission of Canada (1980). See also Economic Council of Canada (1979).

5. We should recall, when gasoline prices rose dramatically in the past decade, how easy it was to blame the increases on the OPEC cartel. The role of federal and provincial governments in the matter was not widely appreciated -- except during the 1980 federal election campaign when the Liberals promised not to raise gasoline by 18 cents per gallon as promised in the December 1979 Tory budget. As we all know, the "tax take" continued to increase despite a subsequent decline in world oil prices.

6 We are reminded of the situation in Canada in 1957 with respect to transcontinental air travel. There was only one choice: Trans Canada Airlines (now Air Canada). The airline may have been highly efficient, it may have offered good service, and its fares may have been fair. But passengers felt "trapped"; there was nowhere to go if one was annoyed with the Crown corporation. The subjective satisfaction of air travellers appears to have increased when in 1958 CP Air was permitted to offer only one flight per day each way between Montreal and Vancouver at exactly the same fare as its rival. Then there was at least some kind of an alternative.

7. See Thomas Hopkins, "Hunger for housing: boom time for homeowners, — sad days for the outs", Macleans, March 30, 1981, pp. 36-42.

8. See Statistics Canada, Household Facilities by Income and Other Characteristics (Ottawa; Minister of Supply and Services, 1983 Cat. No. 13-567). I am indebted to David Hulchanski for bringing these data to my attention.

9. The existence of a controlled sector may well change the risk characteristics of the uncontrolled sector and hence increase the long-run costs of supplying rental units. See the discussion below.

10. I can generalize this idea to what we might call the "laws of perceived costs". The following costs are irrelevant to individual Z:

    - costs whose impact are not borne by Z for several years;
    - opportunity costs borne by Z (i.e., Z feels only outlay costs);
    - costs that are borne by Z but are hidden from Z's purview; and
    - costs borne at any time by persons other than Z or his (her) immediate family.

    We can extend these "laws" or perceived cost by stating that:

    - costs borne by those whom Z dislikes or of whom he is envious are benefits to Z; and
    - allocative efficiency costs, unless they result in near term cash costs to Z, are irrelevant to Z.

    More generally, see Knetsch et al. (1984) on the individual's perceptions of costs.

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Research Studies

The following is a list of papers commissioned by the Inquiry.

No.	
1	Slack, Enid and Sherry Glied. Rent Registry Alternatives.
2	Reid, Frank. Collective Bargaining for Tenants.
3	Jaffary, Karl D. Problems in the Regulation of Rents for Roomers and Boarders.
4	MacDonald, Daniel V. Constitutional Reference Re: The Residential Tenancies Act.
5	Fallis, George. Possible Rationales for Rent Regulation.
6	Hulchanski, J. David. Market Imperfections and the Role of Rent Regulations in the Residential Rental Market.
7	Sharp, Campbell, Pannell Kerr Forster Campbell Sharp. Survey of Financial Performance of Landlords.
8	Marks, Denton. Housing Affordability and Rent Regulation.
9	Steele, Marion and John Miron. Rent Regulation, Housing Affordability Problems, and Market Imperfections.
10	Clayton Research Associates Limited. Rent Regulation and Rental Market Problems.
11	Makuch, Stanley M. and Arnold Weinrib. Security of Tenure.
12	Hartle, D.G. The Political Economy of Residential Rent Control in Ontario.
13	Slack, Enid and David P. Amborski. The Distributive Impact of Rent Regulation.
14	Knetsch, Jack L., Daniel Kahneman and Patricia McNeill. Residential Tenancies: Losses, Fairness and Regulations.
15	Stanbury, W.T. Normative Bases of Rent Regulation.
16	Stanbury, W.T. Normative Bases of Government Action.
17	Stanbury, W.T. and P. Thain. The Origins of Rent Regulation in Ontario.
18	Stanbury, W.T. and I.B. Vertinsky. Rent Regulation: Design Characteristics and Effects.
19	Chant, John. Overview of Alternative Rental Housing Policies.
20	Foot, David K. Housing Demands: A Demographic Perspective.

21 Quirin, G. David. Regulatory Systems and their Applicability to Rent Controls.

22 Mascall, M. and Associates. Report of the Ontario Rental Housing Market.

23 Environics Research Group Limited. Financing Residential Rental Accommodation: A Survey.

24 Ekos Research Associates Inc. A Study of Landlords and Rent Regulation.

25 des Rosiers, Francois. A Rent Control System in Quebec.

26 Slack, Enid. The Costs of Rent Review in Ontario.

27 Muller, Andrew. Workable Rent Regulation: A Synthesis.

The following is a list of papers prepared by the research staff of the Inquiry.

28 Adams, Eric B., Pearl Ing and John Pringle. A Review of the Literature Relevant to Rent Regulation.

29 Adams, Eric B., Pearl Ing, Janet Ortved and Mary Jane Park. Government Intervention in Housing Markets: An Overview.

30 Pringle, John. Ontario's Residential Tenancies: A Statistical Profile.